INDIAN ECONOMICS

By the same authors

INTRODUCTION TO ECONOMICS

PART I: ELEMENTARY PRINCIPLES OF ECONOMICS

PART II: ELEMENTS OF INDIAN ECONOMICS

ELEMENTARY ECONOMICS

INDIAN ECONOMICS

A COMPREHENSIVE AND CRITICAL SURVEY

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PREFACE

The pace of economic development in India has been quickened appreciably in recent years, especially since the advent of the Congress Ministries in several of the Provinces. Although barely two years have elapsed since the last edition of this volume was published, extensive changes have had to be made in almost every chapter. In fully revising the volume for this fifth edition opportunity has been taken to bring facts and figures up to date and to review the economic position of India in relation to recent world trends of recovery and 'recession'.

In Chapter I, 'Industrialization: Means and Methods', recent measures for establishing state-aided Industrial Credit Corporations in the United Provinces and Bengal have been noticed. In Chapter II, 'Industries: Old and New', the striking increase in industrial production in the last few years and other developments such as the establishment of the cement merger and the steps taken by the Government to extend help to cottage industries have been considered. In Chapter III, 'Industrial Labour', the labour policy of the Congress Ministries, the progress made by labour legislation (Central and Provincial) during the last two years and the work of the Textile Labour Enquiry Committees have been dealt with. Space has been found in Chapter V, 'Transport', for a review of recent railway finance, the recommendations made by the Railway Enquiry (Wedgwood) Committee, co-ordination of road and rail, the Motor Vehicles Bill, the new Road Resolution (1937) governing the road policy of the Central Government, and the fresh attempts at regulation of coastal traffic. In Chapter VI, 'The Trade of India', the partial recovery in the external and internal trade of India as well as the setback due to the 'recession' of American origin and other factors has been discussed. The two Chapters (VII and VIII) on Currency and Exchange have been brought up to date and include a brief account of the move for the devaluation of the rupee. In Chapter IX, 'Prices in India', the limited rise in Indian prices followed by a downward tendency due to world causes has been noticed. In Chapter X, 'Banking and Credit', the attempts made to link the indigenous bankers with the Reserve Bank of India, the working of this Bank during the first three years of its existence and the present position of banking legislation in this country have been discussed. The revised Chapter XI on Finance and Taxation deals with the present revenue position of the Central and Provincial Governments with special reference

to the new excise policy in favour of prohibition, public expenditure, the proposed reform of the income-tax through the new Income-Tax Bill, and the working of the Niemeyer Award. In Chapter XII, ' Unemployment ', the discussion of the problem of unemployment has been brought up to date and recent Government measures to cope with this problem have been noticed. In the last chapter, ' Ottawa and other Trade Agreements ', the negotiations for a fresh Indo-British Trade Agreement, the breakdown of the Textile Talks at Simla and the revised (1937) Indo-Japanese Trade Agreement have been surveyed and the question of exploring the possibilities of further bilateral agreements for India examined.

Bombay
November, 1938

G. B. JATHAR
S. G. BERI

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CHAPTER I

INDUSTRIALIZATION: MEANS AND METHODS

§1. **Protection as a help towards industrialization.**—The people in this country have always looked to the State for leading the nation into new paths, and the extreme form of individualistic philosophy which once dominated popular thought in England and which regarded all State interference as 'mere vanity and vexation of spirit' never had much following here. And it is all the less likely to gain adherents in India now that it stands largely discredited in England itself. The State will, therefore, be called upon actively to interest itself in the matter of industrialization and take the initiative in devising and enforcing measures calculated to promote it. The first place among these measures is generally accorded to a definitely protective tariff.

§2. **The main argument for protection in India.**—In support of the policy of protection for India, the main emphasis is generally placed on what is called the infant industry argument. It is assumed that under protection a large number of industries will spring up and, if assured of reasonable profits during the early years of development, they will rapidly grow in strength and efficiency so that they will be able eventually to dispense with all artificial aid, and that the loss entailed during the initial stages of development will be more than covered by the ultimate advantage to the nation. The Fiscal Commission quote with approval the following words of Professor A. C. Pigou, pointing out their obvious applicability to India: 'The case for protection with a view to building up productive power is strong in any agricultural country which seems to possess natural advantages for manufacturing. In such a country the immediate loss arising from the check to the exchange of native produce for foreign manufactures may well be outweighed by the gain from the greater rapidity with which the home manufacturing power is developed. The "crutches to teach the new manufactures to walk", as Colbert called protective duties, may teach them this so much earlier than they would have learnt it, if left to themselves, that the cost of the crutches is more than repaid.'[1]

§3. **Protection and diversification of industry.**—The development of a varied type of industry is in itself a desirable goal as affording a field for the employment of different grades of skill and as having a salutary influence on the national character, and in so far as

[1] *Fiscal Commission Report*, par. 74.

protection leads to such development we have another argument in its favour. It would, however, seem needless for this country to undergo any special sacrifice for the express object of securing a sufficient diversification of industries, as this object will be incidentally fulfilled even if protection is extended only to those industries which will eventually be able to discard it.

§4. **Protection and national self-sufficiency.**—Protection is sometimes advocated on the ground that it can be used for making a country economically self-sufficient. It may, however, be pointed out that those who are in favour of protection are also for encouraging exports by every possible means. But this is clearly incompatible with the ideal of self-sufficiency as imports must increase *pari passu* with exports. Apart from this consideration, it may be questioned whether national self-sufficiency is any more desirable an ideal than individual self-sufficiency. As Dr Edwin Cannan remarks, 'the superlative protectionist is the hermit who declines to buy anything from his neighbours'.[1] And a hermit nation is no more worthy of admiration than a hermit individual. A nation which refuses to buy anything from other nations must either itself produce all that it needs or must go without some things which add to its well-being; in either case there will be a loss in terms of welfare. Generally speaking, the ideal of self-sufficiency should be pursued only within the limits set by the principle of comparative cost, and protection thought of only in connexion with those industries in which a country possesses undoubted natural advantages.

The doctrine of national self-sufficiency is often supported from the standpoint of national defence. National safety, it is argued, requires that a country should aim at economic independence even if this should entail a permanent burden on the community. It may indeed be feasible and desirable to sacrifice economic considerations and to nurse certain industries for the avowed purpose of national defence. And yet it would be sheer folly to try to regulate the whole of the normal peace economy on a war basis. The fact that India is a huge country possessing varied resources brings self-sufficiency more within the bounds of practicability for her than, for example, for a country like Great Britain. She need not, for example, depend on foreign countries for her food supplies. But it is neither possible nor desirable that she should be completely independent of other countries for the satisfaction of all her wants. Even as regards military requisites, not all of them can be produced in the country itself and some of them cannot

[1] *Economic Journal* (March 1919), p. 79.

be produced except at too heavy a sacrifice. The principle of protecting an industry on the ground that it is essential for the purpose of national defence is valid enough in a general way, but in every case it will be necessary to weigh the military value of the industry against the economic sacrifice required for maintaining it, and ‘ the final decision must be based on a sense of proportion ’.[1]

The following extracts from Mr Aldous Huxley’s book, *Ends and Means*,[2] are interesting as illustrating a new point of view on the subject of national self-sufficiency: ‘ For the sake of prestige and out of fear of what might happen during war-time, most governments now desire, whatever the cost and however great the natural handicaps, to produce within their own territory as many as possible of the commodities produced more easily elsewhere. Nor is this all: the progress of technology has made it possible for governments to fulfil such wishes, at any rate to a considerable extent, in practice. . . . The influence of nationalistic idolatry is now so strong that every contact between nations threatens to produce discord. Accordingly, the less we have to do with one another, the more likelv are we to keep the peace.’

§5. **The case of basic industries.**—Basic industries or ‘ key industries ’, that is industries whose products are utilized as raw materials, on an assured supply of which the prosperity of a large number of important industries depends, have been recognized as deserving special consideration. The work of selecting industries for protection on this ground requires particular care and vigilance, for almost every industry will demand protection on the plea that it is in some sense or other a basic industry; and the interests of the consumers are liable to be needlessly and recklessly sacrificed.

§6. **Protection and public revenue.**—Apart from rapid industrial development, other advantages are also claimed for protection. It is said, for example, that protection will have a salutary effect on the public revenues. To say the least, however, this is highly problematical. If, before levying protective duties, certain commodities were being admitted free of duty, it is obvious that so far the income from customs duties will increase. On the other hand, however, the inevitable rise in prices will decrease the taxable capacity of the consumers.[3] If it is a case of raising an existing duty on the imported article for purposes of protection, the effect

[1] *Fiscal Commission Report*, par. 107. [2] pp. 42-3.

[3] The rise in prices will not be limited to the protected commodities but will generally extend to other commodities as well by ‘ sympathetic ’ action, locally produced substitutes for the imported articles being the first to be affected by the rise in price of the latter (see *Fiscal Commission Report*, par. 79).

on the revenue will depend on the quantity that continues to be imported in spite of the higher duty. If the duty is really effective, the imports ought to contract rapidly with corresponding diminution of revenue. It is conceivable that a very high import duty even with a greatly reduced volume of imports would happen to be most satisfactory from the revenue point of view, but this result cannot be counted upon. In any case, it would always be necessary to make some deduction on account of the smaller taxable capacity of the consumers. It is further conceivable that protection, by concentrating wealth in the hands of a small number of people engaged in the favoured industries, may increase the yield of direct taxes like income-tax (with its usual accompaniments of exemption of minimum income and progression); the larger yield from the higher incomes may outweigh the reduced yield from the taxes on the smaller incomes, direct as well as indirect. The net result of protection on revenue depends on so many complex factors that it is impossible to predict with confidence whether the revenue will gain or lose.

These considerations apply to short-period results. If, however, we take a sufficiently long period for the protective duties to work out their full effects and if we assume that they have been wisely levied, the public revenue ought certainly to benefit in the long run from the enrichment of the country and the greater taxable capacity of the people. But we must keep the short-period and long-period effects separate, and a country entering upon a protectionist regime ought to be prepared for difficulties in connexion with balancing its budget.[1]

§7. **Strong sentiment for protection in India.**—The policy of free trade until recently pursued by the Government was particularly unpopular owing to the suspicion that the open door in India was favoured by England, not so much in India's as in her own interests. The way in which Lancashire was allowed to meddle from time to time with fiscal and industrial policy in this country strengthened this attitude of distrust. Further, the memories of bygone days, when India was renowned for her manufactures, added poignancy to the natural regret felt by patriotic Indians contemplating her present insignificant position as an industrial nation. Other countries like the United States, Germany, and above all Japan, appeared to have prospered exceedingly under, and because of, protection; and arguments, however plausible, that their prosperity was mainly due to quite other causes and that protection was rather an

[1] For example, the protection to sugar, textiles and matches having been found to entail a loss of revenue, the policy of excise duties on sugar and matches had to be adopted in the Budget of 1934-5.

impediment than a help to their industrial development, failed to carry conviction. It was pointed out that England herself had discarded protection only when her pre-eminence in industry had been securely established and that anyhow the beginnings of the free trade regime in England aimed at assisting industry by withdrawing protection from agriculture. Lastly, since 1915 England herself has been drifting steadily into a policy of protection and it now scarcely lies in her mouth to preach free trade to India.

The enormous increase of public expenditure since the War had already compelled our Government very greatly to increase duties on imports—a procedure which was unintentionally protective as regards many manufactures. Such protection being 'casual and haphazard' was bound to carry with it certain undesirable consequences. It gave shelter without any assurance of a permanent policy and not necessarily to industries which deserved it. High customs duties intended for revenue but accidentally protective may, far from accelerating India's development, actually hinder it very seriously, for example by taxing raw materials and semi-manufactured articles. These circumstances may be said to have facilitated the advent of conscious and deliberate protection in this country. However it was not adopted, and it would have been wrong if it had been adopted as a kind of *pis aller*. Protection was introduced for the positive benefits expected from it and not merely as an escape from a system of unintentionally protective revenue duties.

§8. **The cost of protection.**—The doctrine of protection possesses a certain persuasive plausibility, and its appeal is instant to the man in the street not accustomed to economic analysis. In order, however, that protection should be used to the best advantage, it is necessary to have a clear idea of the various kinds of sacrifice it involves, and an intelligent attempt must be made to minimize the sacrifice. In the first place, protection will necessarily increase the cost of living. The consumers will suffer as well as those industries which are not protected, owing to increase of expenses. The burden imposed on unprotected industries is commonly ignored and that is one of the reasons why protection finds ready adherents amongst the uninstructed public.[1]

Wages may rise with the cost of living but generally they do not rise as fast as prices. Although the skilled labourer, especially in the protected industry, will benefit, the unskilled labourers, on

[1] 'For every plus there must be a minus; perhaps people are protectionists merely because it is generally easier to see one plus than a multitude of minuses.'—C. H. Oldham's article 'Industrial Ireland under Free Trade' in the *Economic Journal* (June 1917).

account of their excessive numbers, will probably be worse off as the result of protection. The wages of the agricultural labourer may also rise, particularly in the neighbourhood of industrial centres, but it is doubtful whether they will quite overtake the increased cost of living. As regards the owner-cultivator, his expenses will be greater owing to the higher wages of any outside labour he may employ and the higher prices for his implements. On the other hand, he will get more for the produce he sells.[1] But if he has not much surplus to sell, he will lose by protection. The middle classes will undoubtedly be the losers under a protective system, for their incomes will not rise in proportion to or as fast as the increase in prices. The middle classes, however, have been the strongest supporters of protection in this country. To some extent, no doubt, that is because their education and enlightenment enable them to take a broad national view of protection. They welcome it in the interests of industrial advancement and are prepared cheerfully to face the harder life which it must mean to them as a class. But their enthusiasm for protection is also largely the product of ignorance and incapacity to realize vividly its inconveniences. When, however, it has been in actual operation for some time and produces the expected consequence of enhanced prices, it will be surprising if the present enthusiasm of the middle classes for protection does not sensibly cool off.

§9. **Discriminate protection.**—The policy of Discriminate Protection as adopted in India aims at giving the necessary stimulus to industrial development while minimizing the burden on the community. This involves granting protection only to industries which are proved to be suitable, and insistence on the adoption of efficient methods as one of the necessary conditions of admission to the benefits of protection. Wise discrimination is essential in the best interests of the industries themselves. High duties indiscriminately levied on imports are likely to stimulate a host of weak and inefficient enterprises. Their inevitable collapse will shake the confidence of capital, which is essential for steady industrial progress. They are also likely to unsettle labour because it will be attracted from the sound to the unsound industries in the period of unhealthy boom caused by indiscriminate protection and will be involved in the ruin sure to overtake them sooner or later.

The following general principles of discriminate protection, as enunciated by the Fiscal Commission, have been adopted for the guidance of the Tariff Board—a body first appointed in 1924 to

[1] There is, however, the possibility of a fall of prices of agricultural produce due to the curtailment of exports following curtailment of imports which protection involves.

consider the claims for protection put forward by different industries from time to time.[1]

(i) The industry must be one possessing natural advantages, such as an abundant supply of raw materials, cheap power, a sufficient supply of labour, and a large home market. No industry which does not possess some comparative advantages will be able to compete with the successful industries of the world on equal terms, and therefore the natural advantages possessed by an Indian industry should be analysed carefully, in order to ensure, as far as possible, that no industry is protected which will become a permanent burden on the community.

(ii) The industry must be one which, without the help of protection, is either not likely to develop at all or is not likely to develop so rapidly as is desirable in the interests of the country.

(iii) The industry must be one which will eventually be able to face world competition without protection.[2]

Other subsidiary suggestions are that industries subject to the law of increasing returns as well as those which promise, before long, to satisfy the entire needs of the country should generally be regarded as fit subjects for protection. On the other hand, as a general rule, an industry which can never meet more than an insignificant proportion of the home demand, should not receive protection. Protection of one industry may possibly injure another; but it should not necessarily be refused to an industry on this ground for there may be a net advantage on the whole. Like consumers, the producers also must sometimes be prepared to sacrifice their interests when a policy framed in the general interests of the country requires it.

Protection may sometimes have to be resorted to or increased as a measure against dumping. When dumping is clearly proved to exist and to be injuring some industry whose prosperity is a matter of national concern, a special dumping duty may be necessary. Similar action may be justified against the goods of a country whose currency is seriously depreciated, enabling it to export them at prices which are excessively low in terms of a

[1] It may be noted that while perhaps discriminate protection is a new phrase, the principles embraced by it are not new.

[2] The adoption of this policy of discriminate protection has, according to some critics, led in practice to an indiscriminate refusal to protect on the part of the Government. If, however, it is true that the Government have been unduly cautious, the fault of this cannot be laid at the door of the principles of discriminate protection, which are opposed not only to *too much* protection but also *too little* protection.

relatively stable foreign currency. Lastly, bounty-fed articles coming from abroad may necessitate special measures of protection and there is already legal provision in this country for dealing with such a contingency. Act XIV of 1899 provides that 'where any country pays directly or indirectly any bounty upon export, the Governor-General-in-Council may, by notification in the *Gazette of India*, impose an additional duty on importation into India equal to the net amount of such bounty'.

In the opinon of the Fiscal Commission the industries that will be found to deserve protection will generally be young industries. They recognize, however, that occasionally cases may arise where protection even to a strong and well-developed industry may be justifiable so as to enable it to recover from temporary depression due to causes beyond its control. No universal and dogmatic rule can, therefore, be laid down as regards the stage of development at which protection is justified.

In the case of absolutely new industries, however, the Commissioners think that it would be running too great a risk to grant protection relying on 'the anticipations of the promoters' of the new venture rather than on actual facts. But even in dealing with existing industries, it will not be possible altogether to avoid the traffic in anticipations and uncertainties. What the Tariff Board will be expected to pronounce judgement upon will be precisely the anticipation of the applicants for protection that with its help their industry will prosper and be able ultimately to stand on its own legs. No doubt, the industry being already established, there will be some solid facts to go upon, making the forecast about its future course so far less speculative. The speculative element would be greater when it is proposed to extend protection to an industry in order that it may develop some new branch. The Commissioners do not look with disfavour on the policy of protecting an industry on this ground.[1] It is thus clear that the element of uncertainty will always be present in a greater or less degree in every case where protection is demanded. It may happen, however, that even in the case of an absolutely new industry, reliable data available in other countries where it has been securely established, may be of such a character as to leave no reasonable doubt about its success here. The Fiscal Commission think that generally in the case of new industries, protection will not only be objectionable but unnecessary, as the financial necessities of Government will compel the retention of a general level of fairly high revenue duties and this will give all the protection that is necessary at the start. But this

[1] See *Fiscal Commission Report*, par. 100.

rather underrates the difficulties of making a start and loses sight of the fact that, in some cases, the beginnings may present far greater difficulties than the later stages of development and may require assurance of substantial help from the State before an industry, otherwise promising, can be started at all. The principle of the Government assisting new ventures by providing the necessary guarantees for a bank granting accommodation (see vol. I, ch. xiii), which has been favourably received in most quarters, is not essentially different from the principle of giving consideration to them with a view to protection. The main point involved in each case is whether the industry satisfies the general conditions laid down above. However, the Fiscal Commission's suggestion that bounties should be the rule rather than a protective tariff in the case of new industries, seems sound because so long as an industry is not supplying any considerable proportion of the total needs of the country, a protective duty will entail too heavy a burden on the consumer.

After it is decided to grant protection to an industry, the next important question is to settle the rate of protection. Too heavy a rate would be wasteful and demoralizing. The industry should not be protected so thoroughly that it ceases to exert itself any further. What is really wanted is a stimulant and not an opiate. The task of fixing upon a rate of duty that is just and not too much or too little, is most difficult, and in this connexion the question of relative costs will demand careful consideration. It will be necessary to make sure that the relatively higher costs in India are not wholly due to inefficiency or other easily preventable causes. Again, for comparing the costs of production in India and foreign countries, average firms will have to be taken and not more than ordinarily efficient or more than ordinarily inefficient firms.[1] The rate of protection must also be considered in relation to the convenience of the consumer. A high rate may have the advantage of bringing about a rapid development, but it may have to be low none the less, so as to prevent an undue rise of prices, and a comparatively slow development may have to be accepted as the lesser evil.[2]

[1] To get an idea of the complexity of cost analysis, the reader should refer to Sir J. C. Coyajee, *The Indian Fiscal Problem*, pp. 36-7; V. G. Kale, *Economics of Protection in India*; C. N. Vakil and M. C. Munshi, *Industrial Policy of India with Special Reference to Customs Tariff*, pp. 82-5; and the various reports of the Tariff Board.

[2] In this connexion attention may be invited to Article 3 of the Indo-British Agreement between His Majesty's Government and the Government of India concluded early in 1935. (The Agreement was to remain in force during

§10. **Dangers of protection.**—The Fiscal Commission refer approvingly to Lala Harkishen Lal's maxim, 'Nurse the baby, protect the child and free the adult', as a good summary of the correct principles of protection. The last part of this dictum, namely the freeing of the adult, presents one of the toughest problems of protection, because the adult is apt to kick and otherwise make himself unpleasant if an attempt is made to 'free' him from his protectionist fetters which he finds very comfortable on the whole. When an industry comes under protection, it will naturally try to retain the advantage as long as possible, and one of the methods it may adopt is to disguise its prosperity and make a show of infantine helplessness. But the danger in this is that it may be taken at its word and protection may be withdrawn on the ground that the industry has not derived any benefit from it. The other method is to bring political influence to bear upon the authority invested with the power of lessening or withdrawing the duty. To fix a definite period for protection at the time of granting it is not practicable, because the conditions affecting the industry cannot be counted upon to remain unchanged. If conditions are fundamentally changed, it will be necessary to reconsider the position and possibly extend the period of protection.

The Fiscal Commission express the view that the only way of maintaining satisfactory control would be for the Tariff Board to review periodically the position of the protected industry and make reasoned recommendations as to whether the duty should be continued or withdrawn and, if continued, whether the rate should be modified.

To perform this task effectively and without prejudice or favour, requires rare intellectual and moral qualities besides a thorough knowledge of economic theory and facts. It is, therefore, necessary to choose the personnel of the Tariff Board with the greatest possible care. The success of the protectionist experiment depends on the manner in which this body works, for the Tariff Board has been erected into a kind of *deus ex machina* which is expected to

the currency of the Ottawa Agreement of 1932.) Under this article, the Government of India undertook that the measure of protection to be afforded to an industry should only be so much, and no more than, would equate prices of imported goods to fair selling prices for similar goods produced in India. A direction to this effect was accordingly included in the terms of reference issued to the special Tariff Board appointed by the Government of India in September 1935 to inquire into and report on the protection to the Indian cotton textile industry against textile imports from the United Kingdom. In former years the Board was given discretion to determine its own method of arriving at adequate protection for an industry.

solve every difficulty that will arise in giving practical effect to the policy of protection.[1]

The real difficulty of the Board will begin when powerful vested interests arise under the shelter of a protective tariff and seek to manipulate it in a selfish spirit and to the prejudice of the country in general. The experience of this and other countries shows that a competent and honest judiciary can be obtained if serious attention is given to the matter, and if a pure judiciary can be secured, there is no reason to despair of securing a competent and incorruptible Tariff Board. But it is a more difficult matter to secure a Legislature and a Government not liable to be influenced by particular interests in shaping the tariff policy of the country. In most countries which have adopted protection, tariff legislation is the resultant of the struggle of interested cliques and rarely follows a definite intelligent plan conceived in the interests of the country as a whole. The Fiscal Commission, however, point out that the danger of political corruption is not so great in India as in some other countries on account of the variety of interests represented in the Legislature and the important position which the agricultural and landed interests will always occupy in the legislative bodies. This is perhaps taking an unduly optimistic view of the situation and underestimating the dangers of political corruption. The interests which prosper under protection will be able to command larger resources and better organization than the interests opposed to them, which would be too varied in character to combine effectively. At the same time all these dangers have to be faced, now that the plunge has been taken deliberately. The utmost publicity should be given to the investigations by the Tariff Board into the conditions of the industries soliciting special treatment. This would reduce the danger of corruption, provided the public is sufficiently instructed and vigilant. It would be highly desirable if

[1] Mr N. S. Subba Rao in his Presidential Address at the Indian Economic Conference, Allahabad, 1929, suggested that the present Tariff Board in India should be converted into a National Economic Board on the lines of permanent bodies like the Tariff Commission and the Federal Trade Commission in the United States which make investigations as the result of a comprehensive plan of action. The Tariff Board may be suitably enlarged and allowed to appoint sub-committees and individual expert investigators. It should have power to make inquiries and surveys on its own initiative, and submit recommendations to the Government from time to time. This would replace the present hurried and piecemeal investigations, lead to an orderly economic development and facilitate the necessary industrial adjustments in the country. Sir H. P. Mody suggested in March 1936 in the Assembly that the Tariff Board procedure should be revised to make it more speedy and effective as in the case of the Import Duties Advisory Committee in Great Britain.

consumers also learnt to organize themselves into powerful associations and helped to keep protection within legitimate bounds.

Besides political corruption, another evil to be guarded against is the development of combinations of manufacturers, which is stimulated by protection. Here again it would fall to the Tariff Board to make sure whether a combination that may have arisen is actually injurious to the country and, if satisfied that such is the case, to recommend diminution or withdrawal of protection.

§11. **Protective export duties.**—Something has already been said in another connexion about the economic effects of restrictions on the free export of the raw materials of industry, and we have seen that export duties cause a disproportionate injury to the producer of raw materials without being of appreciable assistance to the manufacturers. The duties would have to be very high even to produce a comparatively small difference in the cost of the finished article in favour of the home manufacturer as the cost of raw materials generally forms but a small part of the total cost of the manufactured article, and the hardship to the producer will be so great as to make unthinkable the adoption of any general system of protection on this plan. Moreover, if protection to a particular industry is necessary, its burden should rest as far as possible on the shoulders of the whole community. It is a wrong principle to penalize only one particular class for the benefit of the protected industry. For this reason, as we have already suggested, bounties and protective import duties are to be preferred to export duties. Another objection to export duties is the risk of a loss of the foreign market altogether, as our bitter experience in the case of saltpetre has shown.

§12. **Other essentials than protection.**—India has adopted protection as an essential aid to the speedy development of industries. We cannot, however, merely legislate a nation into wealth and prosperity, and protection alone will not convert the medieval organization of a country into an up-to-date modern organization as it were by the wand of a magician.[1] Even with protection, a country may remain for ever economically backward in the absence of an adequate development of indispensable adjuncts of modern economic life such as an efficient banking organization, a properly developed system of transport, a sympathetic railway and shipping rates policy, an effective marketing organization, an efficient system of commercial and industrial intelligence, adequate command of capital, etc.

[1] See Coyajee, op. cit., pp. 33-4.

§13. **Education.**—Above everything else, what is required is a change in the mental outlook of all classes of people in India.[1] We have too long been under the spell of the mischievous ideas that poverty is inevitable and that wealth and industrial greatness comparable to those achieved by the foremost European nations are beyond the reach of India. The diffidence and lack of enterprise which characterize the Indian people today, are defects largely attributable to the present faulty system of education. It has long been a commonplace of educational discussions in this country that from top to bottom our educational system is too literary and academic, and that it is necessary to give a more practical bent to it. The idea that all education creates a distaste for manual labour is erroneous for, quite on the contrary, a sensibly planned system of education will take particular care to emphasize

[1] Asked by an old pupil what he thought of protection for India, Dr Alfred Marshall wrote :—' I have no objection on principle to the " protection " of nascent Indian industries. But a customs tariff is an expensive method to this end : and under existing circumstances it would enrich European capitalists rather than Indian. Therefore, I think it should not be applied until other methods have been tried, not until those industries which already receive *a very high* protection from cost of carriage (in some cases double cost of carriage) have succeeded in evoking Indian enterprise. Strong cases in point I understand to be the leather, paper and oil-seed industries. If India had a score or two of men like Mr Tata, and some thousands of men with Japanese interest in realities, with virile contempt of mere speech-making in politics and law courts; and with no scorn for work on *things* while the mind was full of *thoughts*, India would soon be a great nation. Nothing could stop her : no tariff could hinder her : she would enter into her heritage. But so long as an Indian who has received a high education generally spends his time in cultured ease; or seeks money in Indian law suits—which are as barren of good to the country as the sand of the seashore—nothing can do her much good; so long as, with the exception of Bombay cotton which after all is of Parsee origin and a few works of which Mr Tata's are at the head, all enterprise seems to be in European hands, in spite of the fact that the unhealthiness of India for the young children of Europeans is in effect a protective duty of perhaps 50-100 per cent in favour of Indian enterprise in India as against European. For twenty years I have been urging on Indians in Cambridge to say to others : " How few of us when we go to the West think of any other aim save that of our *individual culture?* Does not the Japanese nearly always ask himself in what way he can strengthen himself to do *good service to his country* on his return? Does he not seek real studies? Does he not watch the sources of Western power? Is not that the chief reason for Japan's quick progress? Cannot we imitate her? Do we need any other change than, like the Japanese, to think of our country in the first place and ourselves as long way behind? " '—(A. C. Pigou, *Memoirs of Alfred Marshall,* p. 472). For better or worse (we think, on the whole, for better) India has made up her mind in favour of protection. None the less, Dr Marshall's words deserve to be pondered over; for, protection or no protection, no considerable economic progress is possible unless the defects in national character which Dr Marshall points out are remedied.

the principle of the dignity of labour. One of the ideas in a sound scheme of education would be to make the scholar use his hands and eyes as much as possible. Subjects like drawing and manual training, which are very valuable from this point of view, must be included in the curriculum for primary education. Lack of any education or of education of the proper kind not only makes the Indian workman inefficient and unreliable, but also kills all desire for self-improvement. Education will develop his wants, produce in him an incentive to work more and better in order to satisfy them, and raise the whole tone of his life. One of the difficulties under which Indian industries labour, is that skilled labourers as well as supervisors and foremen have often to be imported from abroad. The men thus imported are naturally expensive and they have to be given a high scale of wages and, in addition to this, heavy expenditure has to be incurred in connexion with their repatriation. The Fiscal Commission recommended that the Government should make the training of apprentices one of the conditions of the tender when they place important orders with foreign firms. Besides skilled labourers, supervisors and foremen, it is necessary to have Indian managers. The system of State technical scholarships abroad can satisfy the need for the necessary training in this connexion only to a very limited extent. The only real solution is to start technical institutes of all grades in the country itself so as to make it possible for Indian industries to dispense with foreign labour of every kind. Research in industrial problems is a function of the highest importance and the necessary institutions for this purpose must be created and maintained either at private or at public expense. For industrial progress something more than mere technical knowledge is required. Men of insight, daring and organizing ability are necessary to lead the country in the industrial march and to enable it to keep pace with other nations. The multiplication of commercial colleges is likely to help men of this type to discover themselves. The present deficiency in this regard is at least partially due to the fact that our educational system has not hitherto made it its special business to foster the qualities required for making a successful business man. The excessively literary character of the education, which was originally intended merely to provide for the administrative needs of the Government, has been in some measure mitigated in recent years by the increasing importance given to the teaching of modern science in our schools and universities. The personal contact with specific realities and the exercise in verifiable reasoning which the laboratory makes possible, have an obvious bearing on the thoughts and actions of men, which are thereby turned into useful practical channels.

Commercial and technical schools and colleges ought also to have the same desirable effect. The increasing keenness of the struggle for existence is gradually forcing the educated classes to seek careers in business rather than in Government service, which cannot possibly provide for an unlimited number of graduates. The attractions of Government service and the overcrowded professions of law and medicine will diminish when other numerous openings are offered by the development of industries. All these changes are already perceptible, but only just perceptible. They must proceed far more rapidly than at present, and for this heroic efforts are necessary in order to improve and extend educational and industrial opportunities.

§14. **The position of industrial education in India.**—The Government seem to have realized their necessity and importance as early as 1888, when a Resolution was issued on the subject calling upon the Provincial Governments to take action in the matter. The practical effect of this, however, was almost nil and for a long time the Victoria Jubilee Technical Institute, started in 1877 in Bombay, chiefly through private efforts to provide courses of instruction suitable to the needs of the growing local mill industry, was the only institution of its kind in the country. The investigation into the defects of the educational system of India set on foot by Lord Curzon, who called a conference of educational experts at Simla in 1901, raised the question of technical education once more, but the only practical outcome of this was some improvement in the teaching of science at the universities and the institution of a number of technical scholarships by the Government of India to enable Indians to proceed to England and America. This system also did not work well for several reasons, such as the selection of unsuitable candidates, the difficulties experienced by Indian scholars abroad in getting real practical knowledge in regard to the technique and organization of industries, and the difficulty of providing suitable employment for them on their return. The rules in connexion with these scholarships have been recently revised so as to remove some of these defects.

In recent years the question of technical and general education has figured prominently in public discussions. It received detailed attention at the hands of the Industrial Commission (1916-18), the Calcutta University (Sadler) Commission (1917-19) and the committee appointed by the Government of Bombay in 1921. The Industrial Commission made a number of recommendations for (i) the provision by local Governments and authorities of a suitable system of primary education with an industrial bias for the artisan and labouring population, including subsidization of such of the

employers of labour as might undertake to supply educational facilities for the benefit of their employees; (ii) provision of industrial or craft schools under the control of the Department of Industries for cottage industries; and (iii) provision for the training of men for organized industries. These were divided into the manipulative industries such as mechanical engineering, and non-manipulative or operative industries, such as the manufacture of chemicals. The training for the foremen was to be given in the works themselves, to which theoretical classes were to be attached, though in some cases like the textile trade, in technical schools with workshops attached to them. For the operative industries technological schools were to be started with attainment of practical experience in the factory. In addition to the existing provincial institutions the Commission recommended the establishment of two Imperial Colleges, one for the highest grade teaching of engineering, and the other for metallurgy and mineral technology.[1]

Under the 1919 Reforms, education became a provincial transferred subject, the promotion of industrial and technical education being controlled by the Provincial Departments of Industries. But owing to financial stringency, no solid results have so far been achieved. Even primary education is making very slow progress in spite of the enabling and compulsory Primary Education Acts that have been passed in several provinces and the raising of the age of employment of children in factories by the Factory Act of 1922. Recognizing the necessity of a wider extension of technical education and industrial training, the Government of Bombay appointed a committee on technical and industrial education in February 1921. The committee produced two reports, one by the European majority and the other by the Indian minority (the President, Sir M. Visvesvaraya, supporting the minority), the main points of difference between the two sections being in regard to types of institutions, number of pupils to be trained and estimates of cost, and organization and agencies for carrying out the scheme. The majority held the view 'that the best means of giving practical training to young men is by establishing apprentice schools attached to large workshops and factories', and put the estimate of the number to be trained in these schools at 600.[2] The minority

[1] The Indian School of Mines at Dhanbad was opened at the end of 1926 and is intended to serve as a training ground for mining engineers and geologists.

[2] The majority also made recommendations for the education of factory children or half-timers in the 'three Rs', with a practical industrial bias. While the employer's initiative in this respect should be encouraged by the Government, the duty of imparting such education should rest with the Government, who should, if practicable, make such education free and compulsory.

objected that although such part-time schools attached to the small number of factories and workshops existing then would be useful, the provision for such a small number would be thoroughly inadequate. They therefore proposed 'an extension and improvement of the existing system, by the institution of full-time day industrial schools with workshops and laboratories attached' making provision for about 31,000 pupils.

It has not been found possible, however, to take action even on the limited scale contemplated by the Majority Report, though the weaving schools maintained by the Department of Industries continue to help the hand-loom industry. Thus the present position in regard to general, technical and commercial education is unsatisfactory and the actual provision that has been made by Government or private effort can scarcely be called adequate considering the huge size and large requirements of the country. Also as the Hartög Committee remark, 'such of the attempts as have been made to provide vocational and technical training have little contact with the educational system and are therefore largely infructuous '.[1]

§15. **Stores purchase policy.**—The various public departments as well as the railways in the country purchase immense quantities of stores of all kinds, many of which were till recently imported from abroad, mostly from England, through the Stores Department of the India Office, London. Government stores imported in 1914-15 were valued at Rs. 7 crores, in 1921 at 16·25 crores and in 1928-9 at 10·09 crores. In recent years the value of the Government stores imported has appreciably decreased, being 4·27 crores in 1931-2, 1·95 crores in 1933-4 and 2·48 crores in 1936-7. One way of encouraging industries would be to make purchases of Government requirements as far as possible within the country. Like many another excellent principle this was also recognized long ago without being translated into action. About fifty years ago, the Government enunciated the policy of purchasing, for State use, stores of Indian origin or manufacture rather than stores produced or manufactured abroad. Rules, which were revised from time to time, were also made governing stores purchase, under which preference was to be given to articles wholly or partially manufactured in India, subject to certain conditions as regards quality, etc. In cases where the articles available in India are as good as can be had elsewhere and are as cheap as elsewhere, it goes without saying that preference should be given to indigenous

[1] For statistics relating to professional and technical education, see *Hartog Committee Report*, or to give it its full title, *Review of the Growth of Education in British India by the Auxiliary Committee appointed by the Statutory* (Simon) *Commission*, Appendix IV, and *Indian Year Book* (1937-8), pp. 371-2

goods. There are some who would go even further than this and would have articles of home manufacture preferred even if they were to cost considerably more. Such a policy would entail an increased burden on the taxpayer and would, strictly speaking, amount to a grant of protection. And before action is taken under it in favour of a particular industry involving considerable increase of public expenditure, opportunity might well be given to the Tariff Board to express an opinion on the matter. In any case, the question would require to be considered in the light of the principles of protection as outlined above. It is not clear whether the rules to which we have referred required a preferential purchase of Indian goods even when their prices were appreciably higher.[1] However that may be, in actual practice, according to the finding of the Industrial Commission, preference was given to British stores even when they could have been supplied equally well both as regards price and quality by Indian manufacturers, who were handicapped in various other ways in meeting the demands of the Government departments when competing with tenders received by the India Office Stores Department in London. The failure on the part of the Government to avail themselves of the stores purchase rules and utilize fully the manufacturing capacity of the country was attempted to be excused, if not justified, by pointing out that there was no suitable inspecting agency to direct and advise the indenting officer in India, who relieved himself of all trouble and responsibility by sending orders to the India Office Stores Department in London. The explanation provokes the query why steps were not taken to provide the requisite agency for obtaining expert advice, and it cannot be accepted as a sufficient and satisfactory answer to the charge of remissness and

[1] A Government Resolution on the subject issued in 1928 contains the following instructions: 'The departments of the Government of India or the officers expressly authorized by them in this behalf may, when they are satisfied that such measures are justified, allow a limited degree of preference, in respect of the price, to articles produced or manufactured in India. Subject to the above, preference in making purchases will be given (*a*) to articles which are produced in India in the form of raw materials or are manufactured in India from materials produced in India over articles wholly or partially manufactured in India from imported materials or articles not manufactured in India, provided that the quality is sufficiently good for the purpose; (*b*) to articles wholly or partially manufactured in India from imported materials over articles not manufactured in India, provided that the quality is sufficiently good for the purpose; (*c*) to articles of foreign manufacture held in stock in India over those which would need to be specially imported provided that they are of suitable type and requisite quality; (*d*) to articles manufactured abroad which need to be specially imported.' The Railway Board follows a similar policy in purchase of stores by and on behalf of railways.

anti-national conduct levelled against the Government by their critics. The idea that it is possible to regulate the stores purchase policy in such a manner as to stimulate Indian industries was endorsed by the Indian Industrial Commission. Even if the policy of 'fair field and no favour' is adopted, without what we may call protective preference being shown to Indian manufactures, the advantage of securing the large custom of the Government would in itself act as a healthy and valuable stimulus. Also, as the Industrial Commission have pointed out, if certain suggestions for improving the method of placing orders were accepted, not only would existing industries benefit, but also new industries might be started. For example, if instead of allowing unnecessary diversity in orders for the same kind of goods, standard patterns were adopted, it might be profitable to put down special plant in India in view of the large demand for goods of a standard type which would thus result.

With the progress of industrial development it is becoming more and more possible for the Government to have their needs supplied by local industries, particularly as arrangements have now been made for removing the difficulty arising from lack of information as to sources and market values of Indian supplies and the absence of an inspecting agency. The Stores Purchase Committee appointed in accordance with the Industrial Commission's recommendation supported the latter's suggestion that a central expert agency for the purpose of inspecting Government stores should be established. The Indian Stores Department was instituted accordingly, and though it is intended primarily to serve the Government of India, it is open to the Provincial Governments, municipalities, Port authorities, company-managed railways and other public or semi-public bodies and Indian States to avail themselves of its services. The principal officers of the Stores Department as at present constituted are a Chief Controller of Stores, Director of Inspection, a Director of Purchase and Intelligence, and a Deputy Director of Purchase (Textiles). The Department acts in an advisory capacity as a purchase and inspection agency, scrutinizes the indents with a view to preventing orders being placed abroad when purchases of goods of indigenous origin are possible subject to conditions of price and quality, purchases and inspects certain specified commodities in India, acts as a central bureau of information on all matters connected with the purchase and prices of stores, and discharges other important functions so as to encourage Indian industries. Local purchasing branches have been created at Calcutta and Bombay, and inspection agencies at Madras, Bombay, Karachi, Cawnpore and Delhi. For the convenience and encouragement of Indian firms competing with foreign firms, the Department

has adopted and is progressively developing the policy of inviting rupee tenders for delivery in India. In order to ensure the successful working of the rupee tender system, the consulting engineers to the High Commissioner in London have been appointed expert advisers and have opened a branch office in Calcutta for that purpose. An important part of the work of the Stores Department consists of making continual investigations into the potentialities of indigenous sources of supply, resulting in a constant enlargement of the list of approved contractors in India.

In pursuance of the policy of the Government as enunciated in 1928, articles wholly or partially manufactured in India worth Rs. 15·56 crores were purchased for Government use during the eight years, 1928-9 to 1935-6, by the Indian Stores Department.[1]

§16. **The Industrial Research Bureau.**—The Fifth Industries Conference of July 1934 considered a proposal to establish a Central Industrial Intelligence and Research Bureau with a view to the co-ordination of research. The Bureau now called the Industrial Research Bureau was established in April 1935 with a research branch at Alipore. The Bureau is attached to the Indian Stores Department and has been given a grant of Rs. 5 lakhs spread over a period of three years.[2] Its functions are: the collection and dissemination of industrial intelligence, collaboration with industry in industrial research, the publication of appropriate bulletins giving advice with a view to industrial standardization, and assistance in the organization of industrial exhibitions. The need for such a central agency and the value of industrial research can hardly be exaggerated.

§17. **Work of the Provincial Departments of Industries.**—We have already referred to the establishment of the Provincial Departments of Industries as recommended by the Industrial Commission.[3] The main work of these departments falls under three classes: (i) promotion of technical and industrial education; (ii) supply of industrial intelligence; and (iii) assistance to industries, financial as well as by means of arts and crafts depots and industrial exhibitions.[4] Their activities are, however, largely devoted to the development of cottage[5] and rural industries rather than to large-scale industry. Success on the lines and the scale anticipated by the Industrial Commission has not been achieved by the Departments

[1] *State Action in Respect of Industries, 1928-35*, p. 27.
[2] ibid., p. 47.
[3] See vol. I, ch. xiii, §4.
[4] For an account of the work done in the various provinces see A. G. Clow, *The State and Industry*; and *State Action in Respect of Industries, 1928-35*.
[5] These activities are reviewed in the chapter following.

of Industries, because of want of funds and the great change, since the time of the Industrial Commission, in industrial conditions. The constitutional changes of 1919, by which responsibility for industrial development devolved largely on the provinces, have also handicapped the adoption of a systematic and comprehensive industrial policy. A certain amount of useful co-ordination has, however, been effected through the annual sessions of the All-India Industries Conference which are attended by the Provincial Ministers and Directors of Industries and also representatives of some Indian States. Comparatively greater success has attended the efforts of the Bengal Industries Department, which with its fully adequate staff and after the opening of a research laboratory in Calcutta, may be regarded as well equipped to carry out the policy recommended by the Industrial Commission. The Industrial Chemist in that province has undertaken a number of investigations relating to the better utilization of raw materials available in Bengal. The Bengal Tanning Institute is doing research work on problems connected with local leather and tanning. We may also mention the industrial surveys carried out in the United Provinces, Bengal and Madras. Demonstration factories have been started in some provinces. But unfortunately only a few of them, as for example, the manufacture of ink in Madras, have proved successful; others like the Government tannery at Lahore and bobbin-manufacture in the United Provinces have failed.

We have already referred to the Acts passed by some of the Provincial Legislatures for giving financial assistance to industries. These Acts have been in force in Madras, the Punjab and Bihar and Orissa since 1923. Similar Acts passed in Bengal and the Central Provinces became law in 1931 and 1933 respectively. Under these Acts, loans can be given to private enterprises for starting new industries subject to certain conditions. In actual operation these Acts have been of greater use to small, rather than to large-scale industries.[1] The failure of the few big loans given to large concerns like the Carnatic Paper Mills (Madras) and the Indian Steel Wire Products Ltd. (Bihar) only serves to emphasize the need for special measures to solve the problem of financing large industries.

The Report of the Madras Department of Industries for the year ending March 1935 confessed that during the period of twelve years that the State Aid to Industries Act had been in force, it could not claim to have achieved any measure of success in stimulating

[1] See *Proceedings of the Fifth Industries Conference* (1933) and D. R. Gadgil, *Industrial Evolution of India* (third edition), p. 313.

industrial development, and suggested that, following the example of the United Provinces, a special committee should be set up to formulate a new scheme of financial aid to industries. The Committee in the United Provinces known as the Industrial Finance Committee had been appointed in 1934 under the chairmanship of the late Sir S. N. Pochkhanawala. This Committee held that direct State aid to industries was not desirable. It recommended the establishment of a joint bank called 'The United Provinces Industrial Credit Bank, Limited', with a capital of Rs. 25 lakhs, with a Government guarantee for a maximum period of 20 years of a 4 per cent dividend on the shares free of tax in order to provide long and short term credit to major and minor industries. The Committee also suggested the starting of a new marketing organization to be called 'The United Provinces Financing and Marketing Company, Limited', run on joint-stock lines with a capital of Rs. 5 lakhs, to be underwritten by the Industrial Bank.[1] The United Provinces Legislature approved of the Government's scheme generally drafted in accordance with the Committee's recommendations, in June 1936.[2] The Bengal Legislature also approved the establishment of an Industrial Credit Corporation in December 1936. It is meant for providing loans for the establishment of small-scale industries by released detenus and by any Bengal citizen who can put forward feasible propositions. It remains to be seen how far these new experiments in industrial finance will fulfil the purpose in view.

From the above survey it will have been clear that since the War India has entered upon a new phase of development. The old policy of laissez-faire has given place to a policy of active intervention on the part of the Central as well as the Provincial Governments to regulate and expedite industrial advance.

[1] *State Action in Respect of Industries, 1928-35*, p. 42.

[2] Further particulars of this scheme are indicated in the sections dealing with Industrial Finance in ch. x

CHAPTER II

INDIAN INDUSTRIES: OLD AND NEW

§1. **Scope of the chapter.**—Indian industries may be divided into two classes: (i) industries carried on in the home of the worker which may be called the cottage industries. Here the scale of operations is small, organization limited and the supplies intended largely for meeting local needs. These we shall discuss at the end of this chapter; (ii) organized industries carried on in the workshops or factories which vary in size from simple rural factories carrying out a single operative process to the large textile mills and engineering workshops employing thousands of hands and possessed of a complete organization, both for manufacture and trade. Organized industries connected with agriculture such as tea, coffee, indigo and sugar industries have been already treated under agriculture. We shall now first of all attempt a description of the principal organized industries of the new type in India. This will give us some idea of the advance in industrialization already made and incidentally throw light on the manner in which the new protective system is being applied under the guidance of the Tariff Board.

§2. **Statistics of industrial development.**—A fair idea of the extent of industrial development in India can be formed by a combined study of the following statistical sources: (i) the Industrial Census in India taken in 1921, (ii) *Large Industrial Establishments in India* (1935), (iii) returns of Indian factories under the Indian Factories Act in 1935, and (iv) the returns of Joint Stock Companies registered in India and elsewhere than in India but working in India in 1933-4.

(i) *The Industrial Census in India*, taken in 1921, returned 15,606 establishments (employing more than ten persons) giving employment to 2,681,125 persons, the number of females employed per 100 males being 36.[1] The Census statistics exclude agriculture, but include coffee, tea, rubber and indigo plantations as also mining and quarrying.

In all 8,015 establishments used power of one kind or another: 5,293 used steam, 1,335 oil, 1,137 electricity, 165 gas, and 85 water. The use of electric power is increasing as shown by an

[1] For further details regarding the description of the various classes of establishments the reader is referred to the *Statistical Abstract for British India* (1928-9), Table No. 315.

increase in the number of the group of gas and electric works from 14 factories employing 4,680 persons in 1911 to 81 establishments employing 11,528 in 1921.

(ii) *Large Industrial Establishments in India.*—The statistics given below are taken from the publication *Large Industrial Establishments in India in* 1935 (1937).

Large Industrial Establishments in India (1935)

Kind of Establishment	Number	Persons employed
I *Textiles*—	*753*	*827,111*
Cotton (Spinning, weaving and other factories)	398	515,813
Jute Mills	104	280,968
Silk Mills	49	7,050
Woollen Mills	15	6,346
II. *Engineering*—	*888*	*220,587*
Dockyards	12	4,530
Electrical Engineering	64	7,723
General Engineering	305	45,116
Railway Workshops	171	113,610
Shipbuilding and Engineering	17	16,532
III. *Minerals and Metals*—	*114*	*56,159*
Foundries	70	4,371
Iron and Steel Mills	8	34,653
Petroleum Refineries	12	11,050
IV. *Food, Drink and Tobacco*—	*2,957*	*257,584*
Flour Mills	72	5,952
Rice Mills	1,380	78,900
Sugar Factories	174	72,935
Tea Factories	994	66,376
Tobacco Factories	30	11,936
V *Chemicals, Dyes, etc.*—	*514*	*61,530*
Dyeing and Bleaching	53	7,362
Chemicals	23	4,183
Matches	61	21,440
Oil Mills	245	14,934
VI. *Paper and Printing*—	*454*	*48,622*
Paper Mills	9	6,698
Printing, Book-binding, etc.	427	40,284
Paper Pulp	1	665
VII. *Processes relating to Wood, Stone and Glass*—	*532*	*87,066*
Tiles and Brick Factories	138	15,317
Saw Mills	149	14,396
Glass Factories	59	6,953

Kind of Establishment	Number	Persons employed
VIII. *Processes connected with Skins and Hides*—	*68*	*10,276*
Leather and Shoes	11	4,250
Tanneries	30	4,089
IX. *Gins and Presses*—	*2,729*	*216,233*
Cotton Ginning and Baling	2,547	180,153
Jute Presses	104	31,887
X. *Miscellaneous*—	*222*	*52,285*
Grand Total ...	9,261	1,840,792

The large industrial establishments include all factories subject to the Indian Factories Act of 1934 (excepting those in which the average number of persons employed daily is less than twenty), and also those establishments in Indian States which are considered to be of sufficient industrial importance, so far as it has been possible to procure information. The totals of the principal classes (I to X) are given in italics and only the main sub-classes have been included in the above table. Of the 9,261 large industrial establishments, 4,082 were seasonal, employing 363,703 persons, and 5,179 were perennial, employing 1,477,089 persons.

(iii) According to the returns of the Indian factories during 1935 subject to the Indian Factories Act, the total average daily number of persons employed was 1,610,932 and the total number of factories actually working was 8,831 distributed as follows:

Madras, 1,491; Bombay, 1,746; Bengal, 1,595; United Provinces, 496; Punjab, 669; Burma, 965; Bihar and Orissa, 309; Central Provinces and Berar, 696; Assam, 706; North-West Frontier Province, 28; Baluchistan, 16; Ajmer-Merwara, 38; Delhi, 55; Bangalore and Coorg, 21. Of the 8,831 factories, 5,166 were perennial and 3,665 were seasonal.[1]

(iv) *Returns of Joint Stock Companies.*—The increase in the pace of industrialization in India, especially since the outbreak of the War, may be gauged from the following figures relating to Joint Stock Companies registered in British India and in Indian States in 1914-15 and 1933-4 respectively:[2]

[1] *Statistics of Factories for the year ending December 31, 1935*, pp. 1 and 21.

[2] In the case of Indian States, only the total number of factories and their total paid-up capital are given, but not the particulars under each class of companies. We have already given statistics of Joint Stock Companies registered elsewhere than in India but working in India, while dealing with the question of external capital invested in India. We have also discussed the post-War industrial boom, the subsequent trade depression in India and the recovery in the last few years. See vol. I, ch. xiii, §§5, 6 and 14.

Class of Companies	1914-15		1933-4	
	No.	Paid-Up Capital	No.	Paid-Up Capital
		Rs. (lakhs)		Rs. (lakhs
Banking and Loan	436	7,80	1,796	29,15
Insurance	182	50	591	3,03
Navigation	24	1,28	38	2,72
Railways and Tramways	44	8,30	47	15,10
Other Transit and Transport ...	...	...	281	3,98
Trading and Manufacturing ...	754	11,32	3,388	94,21
Tea	208	4,31	485	13,72
Other Planting Companies. ...	29	41	94	1,85
Coal Mining	140	6,09	275	10,46
Gold Mining	8	33	1	...
Other Mining and Quarrying Companies	57	5,76	98	29,34
Cotton Mills	205	16,70	306	32,17
Jute Mills	34	7,61	69	18,75
Mills for Wool, Silk, Hemp, etc. ...	13	1,22	21	2,40
Cotton Ginning, Pressing, Baling, etc.	...	...	106	2,39
Jute Presses	139	2,70	33	2,03
Flour Mills	30	80	30	1,34
Estate, Land and Building ...	32	2,17	159	10,70
Sugar (including Jaggery) ...	22	80	153	4,22
Other Companies	123	2,05	569	10,69
Total (British India) ...	2,480	80,24	8,540	2,88,25
Total (Indian States) ...	65	54	894	12,56
Grand Total ...	2,545	80,78	9,434	3,00,81

The above statistics leave us in no doubt regarding the growing industrialization of India and a considerable growth of large-scale industries in the country, though we are still far from the position held by the industrially advanced nations of the West such as England, Germany or the U.S.A. 'Organized industries as yet play too small a part in the national economy, and even in the industrial population a very large proportion is engaged in simpler, seasonal, miscellaneous or repair industries. Cotton gins and presses, jute presses, rice mills and timber mills, engineering workshops, foundries—all these employ the major portion of the Indian population engaged in modern industry.'[1] All told the population engaged in modern industry is less than two per cent of the total population of the country.

§3. **The cotton mill industry.**—We shall now proceed to give a short account of some of the large-scale industries in India. The first cotton mill in India was erected at Calcutta in 1818. The first mill in Bombay, which was destined to be the home of the

[1] See Gadgil, op. cit., p. 282.

cotton mill industry, was the result of Parsee enterprise and began working in 1854.

The early concentration of the industry in the Bombay island was governed not so much by natural and permanent factors as by other advantages, such as abundance of capital and credit facilities, the presence of cheap and speedy means of transport and the temporary growth of the demand for yarn from China, which Bombay was in an exceptionally favourable situation to meet. The year 1877 marks the turning point in the development of the industry from the point of view of its distribution. It saw the beginning of a rapid construction of mills in up-country centres like Nagpur, Ahmedabad, Sholapur, etc. situated right in the heart of the cotton-producing tracts. This later distribution was influenced to a very much larger extent by natural factors, such as the vicinity of sources of raw material, plentiful labour and large marketing centres, and was made possible by the development of railway communication. The decline of the China trade in yarn from the commencement of the present century also affected adversely Bombay's position of unequalled pre-eminence. The swadeshi movement, moreover, stimulated the growth of weaving outside the Bombay Presidency. Latterly the developments in factory legislation in British India have set up a tendency for the migration of the industry to some of the Indian States where the administration of the Factory Laws is more lax.

Recently, there has been a tendency on the part of the Indian mills to increase the manufacture of finer counts, and a certain amount of long-staple cotton is imported from the U.S.A. and elsewhere for this purpose. But the spinning of finer counts is limited by the expensiveness of foreign cottons as well as that of the new machinery which has to be laid down. An improvement in the quality of the home-grown cotton will help the situation.

The cotton industry received a considerable stimulus from the conditions created by the War. The large patronage extended to the mills by the Government in respect of their military requirements in cotton goods in the Eastern theatres of the War, together with the shrinkage in the Lancashire imports into India due to the preoccupation of the Lancashire mills with War work and the sharp rise in the prices of imported cloth due to shortage of shipping, led to a considerable increase in home production, though the difficulty of importing machinery prevented as speedy a development as would otherwise have taken place. As it was, the home production in piece-goods increased from 1,164 million yards in 1913-14 to 1,614 million yards in 1917-18. The increase was particularly noticeable as regards the better class of goods of high counts which were

mostly imported before the War. The production of Indian mills in the whole country in 1936-7 was 4,336 million yards of woven goods.

§4. **Growth of the cotton mill industry.**—The following two tables bring out the progress made by the cotton mills in the whole of India and the decline in the imports of piece-goods.

Table I[1]

Year ending 30 June	No. of mills	No of spindles	No. of looms	Average no. of hands employed
1877	51	1,244,206	10,385	Not stated
1900	193	4,945,783	40,124	161,189
1914[2]	271	6,778,895	104,179	260,276
1918[2]	262	6,653,871	116,484	282,227
1922[2]	298	7,331,219	134,620	343,723
1923[2]	333	7,927,938	144,794	347,380
1927[2]	336	8,702,760	161,952	384,623
1930[2]	348	9,124,768	179,250	384,022
1932[2]	339	9,506,083	186,341	403,226
1934[2]	352	9,613,174	194,988	384,938
1936[2]	379	9,856,658	200,062	417,803

Table II[3]

	1904-5	1913-14	1919-20	1924-5	1930-1	1934-5	1936-7
				Million yards			
Mill production in India	678	1,164	1,640	1,970	2,561	3,397	3,572
Imports	2,288	3,159	1,064	1,801	882	944	764
Total ...	2,966	4,323	2,704	3,771	3,443	4,341	4,336

The continuous progress of the export trade in yarn till 1904-5 was due to the geographical advantage enjoyed by Bombay with respect to the Chinese market. The mills in the Bombay island supplied more than ninety per cent of the total exports, of which China absorbed ninety per cent. Japan was another important customer till the year 1890. New markets had also been developed in the Straits Settlements and Arabia. After 1905 the trade declined as rapidly as it had developed before. The principal factors that led to the decline were the disturbance in the exchange rates with

[1] *Indian Year Book* (1937-8), p. 698.

[2] Year ending 31 August.

[3] *Review of the Trade of India* (1936-7), p. 42. These figures are exclusive of fents.

China consequent upon the closing of the Indian mints to the free coinage of silver, the rise of the spinning industry in China, the shipping difficulties of the Indian merchants caused by the War which gave to Japan her coveted opportunity, the growth of weaving in India itself, and the neglect of foreign markets on the part of Indian producers due to the large internal profits. It may be noted that Japan did not appear as a rival to India in the Chinese market for yarn till after the outbreak of the War. Since then, however, not only has she succeeded in ousting India from the Chinese market but the imports of Japanese yarn into India itself have increased with alarming rapidity and have seriously affected the prosperity of our spinning industry. The exports of cotton twist and yarn declined from 244 million lb. in 1899-1900 to 193 million lb. (pre-War average of five years); to 130 million lb. (War average of five years); to 82 (post-War average of five years); and to 12·1 million lb. in 1936-7. In the same year the total Indian mill production of yarn was as much as 1,054 million lb. Thus India now exports only a small percentage of her yarn production, practically the whole of it being absorbed in the country itself.

Causes connected with the War led to the memorable boom which started in 1917. The capital investments in the industry increased from 20·84 to 40·98 crores of rupees between 1917-18 and 1921-2. Under the influence of soaring prices the mills were working to their full capacity. The Bombay cotton mill industry paid very high dividends amounting to 40·1 per cent of the paid-up capital in 1919; 35·2 per cent in 1920; and 30 per cent in 1921.[1]

The boom lasted for a period of six years at the end of which the crash came. In the meanwhile, Japan had stolen a march over us not only in the Chinese market but had also begun to pour cheap goods into India, which forced down the prices of goods produced in Indian mills. India had to participate in the world depression as it did in the world boom. The boom and the depression in India belong to what is called the Trade Cycle. Other world factors are the altered relations between agrarian and general prices since 1920 and violent fluctuations in the prices of cotton since 1917. The general depression in industry all over the world is the result of the reduced purchasing power of the agrarian classes due to the fall in the world agricultural prices since 1920. The extensions planned during the boom period were not completed before 1922. "The new concerns started had of course incurred capital expenditure

[1] See *Report of the Tariff Board* (Textile Industry), 1927, Appendix V and Brij Narain, *Economic Life in India*, p. 458.

at the boom level of prices and these high capitalized charges were still further increased in most cases by the turn that exchange took in 1920.'[1] Violent fluctuations in prices of cotton in India affected by the American prices and supplies of cotton since 1917 may be held to be another factor which has increased the embarrassments of the cotton industry in India. While the beginning of the depression was characterized by rising prices of cotton and stationary prices of cloth, during 1925-7 both fell in price considerably. Probably the worst year for the industry was 1923, and the depression was so severe that even a succession of three good monsoons combined with the temporary elimination of Japanese competition owing to the havoc wrought by the earthquake in that country scarcely served to mitigate its severity.

Since the beginning of the present century there has been a remarkable expansion in the weaving industry stimulated by the virtual extinction of the China trade in yarn, and consequently our reliance on foreign cloths has diminished considerably.

§5. **Per capita consumption of cotton piece-goods in India.**—The following table[2] gives interesting figures relating to the consumption *per capita* of cotton piece-goods, including hand-loom products, in India.

Year	Net imports[3]		Net available mill production[4]		Hand-loom production		Net available for consumption	
	Actual	*Per capita*	Actual	*Per capita*	Estimated	*Per capita*	Total	*Per capita*
	Yards (crores)	*Yards*	Yards (crores)	*Yards*	Yards (crores)	*Yards*	Yards (crores)	*Yards*
1905-6	239	*7·97*	61	*2·03*	108	*3·60*	408	*13·60*
1909-10	214	*6·90*	87	*2·81*	90	*2·90*	391	*12·61*
1913-14	313	*9·78*	108	*3·38*	107	*3·34*	528	*16·50*
1918-19	101	*3·16*	130	*4·06*	105	*3·28*	336	*10·50*
1919-20	99	*3·09*	144	*4·50*	56	*1·75*	299	*9·34*
1923-4	142	*4·30*	154	*4·67*	101	*3·06*	397	*12·03*
1926-7	176	*5·18*	206	*6·06*	133	*3·91*	515	*15·15*
1927-8	194	*5·71*	219	*6·44*	131	*3·85*	544	*16·00*
1930-1	87	*2·49*	246	*7·03*	139	*3·97*	472	*13·49*
1932-3	120	*3·34*	311	*8·64*	170	*4·72*	601	*16·70*
1934-5	97	*2·62*	334	*9·03*	146	*3·95*	577	*15·60*
1936-7	79	*2·13*	347	*9·38*	149	*4·03*	575	*15·54*

[1] See Gadgil, op. cit., p. 240.

[2] *Review of the Trade of India* (1936-7), p. 43. These figures are inclusive of fents.

[3] Net imports = Imports of foreign goods minus re-exports of foreign goods.

[4] Net available mill production = mill production in India minus exports of Indian piece-goods.

In calculating *per capita* consumption variations in population from year to year have been allowed for. It has not been possible to take into account exports by land, and stocks left from year to year. The figures for hand-loom production are only estimates based on the quantity of yarn available for consumption each year.

The above table is instructive from several points of view. In the first place, it shows that Indian production is now able to meet the greater part of the total demand for cloth in India and that foreign imports have been substantially reduced. The position in this respect at the beginning of the present century has been reversed. In the second place, the table shows that the hand-loom weaver's contribution to the total amount of cloth consumed in India is still very substantial, being nearly twenty-five per cent of the total consumption and between forty and fifty per cent of the Indian mill production. In the third place, the above table shows that the consumption of cloth *per capita* received a set-back during the War when it fell from 16·50 yards in 1913-14 to 9·34 yards in 1919-20. Since then it has gradually recovered itself, though the process of recovery has been handicapped in recent years by the trade depression which has adversely affected the purchasing power of the masses. The figures for 1932-3 convey a somewhat misleading impression since both production and imports had shown a tendency to peak. It will also be seen that production of piece-goods in India touched a record level in 1936-7.

§6. **Some difficulties of the cotton mill industry.**—The position of the trade in piece-goods is in some ways more secure than that of the yarn trade. The weakness of the yarn trade lay in its excessive dependence on one market, that of China, while as regards the export of piece-goods, it commands a large number of markets, some of which are showing ~~a steadily growing capacity~~ for consuming Indian goods. The diminution in the off-take of a single customer is not, therefore, likely to affect the total volume of the trade to any considerable extent. It must, however, be admitted that Indian industrialists have not hitherto put forth any special efforts to develop foreign markets—an omission which is all the more serious having regard to the present state of the industry. The imports of piece-goods advanced considerably before 1930-1. Japan is a formidable rival as her goods, unlike those of Lancashire, compete directly with Indian manufactures. Japan's ability to undersell the Indian manufacturer is due to certain special facilities such as her superior climatic conditions which are conducive to greater efficiency of labour, the larger

employment of cheap female labour which social conditions in Japan make possible, etc. Further, Japan's cotton purchases are on a large scale and highly organized both in the United States and in India (with the Chinese crop in reserve) which gives her a considerable advantage over India, though in regard to short-staple cotton the advantage, of course, is on India's side. The mixed Indian and American grey cotton cloth from Japan is more attractive than the Indian stuff. All these can scarcely be called unfair advantages. But this description certainly applies to the consequences of Japan's failure to ratify the Labour Conventions of the Washington Conference in respect of hours of work, prohibition of employment of young persons and of women during night hours.[1] These conditions are inferior in Japan to those in India and they were obviously so till the Japanese Factory Law of 1926 came into operation in June 1929. Even now Japan enjoys certain advantages as regards hours of work.[2]

The difficulties of the cotton industry have been enhanced by the frequent changes in the currency policy since 1893 and the enhancement of the ratio from 1*s*. 4*d*. to 1*s*. 6*d*. undoubtedly hit the industry very hard at a time when practically the depth of depression had been reached. Regarding the effect of depreciation of Japanese exchange on her competition with India the Tariff Board held that it did stimulate Japanese exports to India while it lasted, from December 1923 to December 1925. In recent years again the relatively greater depreciation of the yen than of the rupee in terms of gold has given an advantage to Japan over India.

The depression in the cotton mill industry is also to some extent to be attributed to certain defects of organization such as over-capitalization; absence of technical experts on the boards of directors leading to expensive mistakes; improper handling of machinery which is also not replaced sufficiently often by new machinery; absence of up-to-date labour-saving devices; uneconomical handling of cotton, coal, waste and stores; absence of a systematic plan of short time when demand is slack, etc. We must also mention the defects of the selling agency system, and the absence of any

[1] 'Double-shift working in Japan gives Japanese industry an advantage of four per cent on the actual cost of manufacture of both yarn and cloth. This advantage is considerably increased if a reasonable return on capital is included in the cost of production.'—*Report of the Tariff Board* (Textile Industry), 1927, par. 32.

[2] For further figures and a survey of present labour conditions, see M. C. Matheson, *Indian Industry*, ch. iv.

satisfactory system of finance,[1] which has seriously inconvenienced both mills and dealers.

§7. **The managing agency system.**—The managing agency system has come in for a good deal of damaging criticism and a few words about it may be permissible.[2] The managing agency is a private partnership of three or four members usually related to each other. The ownership of the agency is in many cases governed by the hereditary principle, so that management often passes into incompetent hands. The managing agents hold a large number of shares in the mill and make themselves responsible for the financing as well as management of the mill, the purchase of supplies and the sale of the goods. Some of the methods of remunerating the agents are apt to lead them into action which, while it adds to their private gain, is prejudicial to the interests of the mill. For example, where their commission is based on the total volume of production, the interest of the agents lies in swelling the output as much as possible irrespective of the effect of such a policy on the profits of the mill. The managing agents have also been charged with taking secret commissions in the course of the buying and selling transactions which they undertake on behalf of the mill. Other disadvantages of the system are that it fosters indifference and ignorance on the part of the directors, who have no real responsibility. It also tends to make the shareholders powerless and irresponsible and therefore unwilling to make sacrifices for the company or invest more money in the business. It further favours excessive conservatism and lack of enterprise. Lastly, the fact that the economic development of India in the nineteenth and twentieth centuries has been commercial rather than industrial is partly attributable to the managing agency system. It is quite true that if the managing agents had not taken upon themselves the responsibility for finance, in many cases providing finance themselves for industrial and commercial ventures, the economic development of India would have been even slower than it has been. Capital in India is proverbially shy, and the welcome change in the direction of greater readiness

[1] 'Another common defect is that many mills depend for working capital mainly on short-term deposits, cash credits and loans, all of which are apt to be drastically curtailed in difficult times.'—Vera Anstey, *The Economic Development of India*, p. 275.

[2] For a brief and instructive account of the origin, uses and dangers of the managing agency system in India, see Anstey, op. cit., pp. 112-15, 253 and *Report of the Indian Tariff Board* (Cotton Textile Industry), 1932, par. 65-83.

to subscribe on the part of the public is only a very recent phase. Even now no bank will make any advance unless the application is signed by the managing agents, who are held responsible in their personal capacity. Apart from the provision of the finances required for industries in respect both of fixed and working capital, the managing agency system is also associated with the pioneering of new industrial enterprises in the sense of prospecting, research, etc. It may also be admitted that in the present times of unexampled depression the managing agents have readily borne their full share of the losses suffered by the industries, and have not only forgone their commission but provided much-needed funds. At the same time, it is now very generally recognized that the time has come for undertaking a radical reform of the managing agency system.[1] The Tariff Board in 1932 recommended an early inquiry regarding legislative action so as to bring the managing agency system under better control. The recently amended Indian Companies Act (1936) seeks to remove many of the managing agency evils by limiting the term of office of a managing agent to twenty years at a time, restricting transfer of his office and assignment of his remuneration by a managing agent, providing for his removal for fraud or breach of trust, prescribing a uniform basis (namely net annual profits) for the agent's remuneration, restricting the grant of loans to and purchase of debentures of one company by another under the same managing agent, etc.

§8. **Depression in Bombay.**—The depression has been specially acute in the case of Bombay owing to circumstances already mentioned, namely the virtual loss of the China trade in yarn owing to Japanese competition and the expansion of the Chinese industry (a loss not wholly compensated by an increase in the export of

[1] 'It may be perfectly true that many, or even most, of the managing agents have performed their functions efficiently and with integrity, but this does not absolve from criticism a system which undoubtedly gives special opportunities for exploitation and even fraud. In any case it is generally recognized that the system is to a great extent responsible for the undoubted fact that industrial and commercial enterprise in India mainly rests with a comparatively small group of individuals, both Europeans and Indians. Consider, for instance, the position of the famous firm of Andrew Yule & Company, which acts as managing agents for a large number of industrial and commercial concerns, including at least ten jute mills, fifteen coal companies, two hydraulic companies, two oil mills, a flour mill, navigation, rubber, sugar, brick and pottery, and miscellaneous concerns of all descriptions (*Capital*, 3 March 1927). It is obvious that incidental earnings must be large and that it must at times be difficult to reconcile the various interests, and still more difficult for any one firm to control the destinies of such a vast and heterogeneous collection of businesses.'—Anstey, op. cit., pp. 501-2.

piece-goods), difficulties of freight during and after the War, and the increase in the severity of internal competition from up-country mills which have shown a remarkable expansion during recent years, especially from mills in the Indian States where labour regulations are lax and where there are often special duties against the products of mills in British India. No doubt part of the blame for this rests on the Bombay mills which have paid insufficient attention to up-country markets in respect of diversification of production, especially in higher counts, more direct contact with the consuming centres and greater alertness on the part of commission agents. But Bombay also suffers from certain serious disabilities for which it cannot be blamed, for example its relatively higher cost of labour, fuel, water power, high local taxation, distance from the mofussil markets and from sources of raw material. That Bombay is losing the dominating place in the textile industry of the country that it had twelve years ago is clearly seen from the fact that the number of mills working in Bombay declined from 78 in 1926 to 66 in 1936. During the same period the number of mills working in Ahmedabad increased from 59 to 79. Nevertheless Bombay is still the home of large combined spinning and weaving establishments.

§9. **Protection to the textile industry.**—Since 1926 the question of protection to the cotton textile industry in India has been examined on three separate occasions by the Tariff Board. The first survey was conducted in 1926, when it became evident that the industry was not in a satisfactory condition, particularly in Bombay. The Board reported in 1927 that the deterioration was mainly due to unhealthy internal conditions, to the unfair and uneconomic competition from Japan and to the general trade depression.[1] To remedy the depression, which was particularly acute in Bombay, the Board suggested a better-organized purchase of raw materials, for example under a single hedge contract system; adoption of various devices to obtain a greater output from labour, such as the piece-work system, greater care in recruitment of labour, better housing and education for the labourer; more combined action furthering common interests on the part of millowners; greater diversification of production and more specialization in products of higher counts so as to take full advantage of the damp climate and the favourable situation of Bombay in respect of the imports of long-staple American and African cotton; development of new lines of production, for example the establishment of the cotton printing industry; more attention to the

[1] *State Action in Respect of Industries, 1928-35*, p. 62.

development of promising markets such as Iran and Mesopotamia; maintenance of a closer touch with consuming centres in India as well as abroad, etc.

As regards protection, the main recommendation of the Board was the raising of the import duty from 11 per cent to 15 per cent, bounty on the spinning of higher counts of yarn and the exemption from import duty of cotton textile machinery and mill stores.[1] The Government of India proposed to accept only the latter recommendation. Strong protests were made against this decision by the millowners, and, as a result, protective duties were imposed on cotton yarn to the extent of 5 per cent *ad valorem* or 1½ annas per pound, whichever was higher, by the Indian Tariff (Cotton Yarn Amendment) Act, 1927 for a period extending up to 31 March 1930. The duty on machinery and mill stores was also removed.

The existing import duty on artificial silk yarn was also reduced from 15 to 7½ per cent, so as to give some relief to the hand-loom industry from the burden imposed on it by the revised import duty on yarn, and to facilitate the diversification of Indian mill production. It may be noted that the hand-looms and cotton mills in India are using increasing quantities of such artificial silk yarn. The Government of India also appointed a Commercial Mission as suggested by the Board.[2] All this, however, did not satisfy either the mill industry or public opinion in India. The depression in the industry continued and the general feeling was that more substantial help was needed.

§10. **Mr G. S. Hardy's inquiry.**—As a result, the Government appointed Mr G. S. Hardy, Collector of Customs, Calcutta, in July 1929 to investigate the extent and severity of external competition.

Mr Hardy's Report fully confirmed the millowners' allegation regarding the Japanese competition.[3] He pointed out that the steady rise in imports from Japan in the past eight years was the most prominent feature of the import trade and that Japan's

[1] The Board also recommended that the Government should give financial assistance to a combined bleaching, dyeing and printing plant, if a satisfactory scheme was put forward by the Bombay Millowners' Association, and that two Trade Commissioners, one at Basra and the other at Mombasa, should be appointed and a rapid survey of the potentialities of other markets should be undertaken by a small Trade Mission including a representative of the Millowners' Association. *Report of the Tariff Board* [Cotton Textile Industry Enquiry (1927), pars. 99-101].

[2] See ch. vi.

[3] See *Report on External Competition in Piece-goods* by G. S. Hardy, par. 11.

progress since the Tariff Board reported had been rapid and uninterrupted. Mr Hardy's inquiry amply proved the necessity of granting substantial assistance to the mill industry, and the Government of India were called upon to make amends for the mistake they had committed in 1927 in refusing to come to the rescue of the industry even on the modest lines recommended by the Tariff Board. They responded by passing in April 1930 the Cotton Textile Industry Protection Act which was mainly designed to afford sufficient protection against Japan until 31 March 1933. In consequence of this Act the general *ad valorem* duty was raised to 15 per cent. In addition to this, in order to enable Bombay to organize itself financially and technically, a minimum duty of 3½ annas per lb. was levied on the plain grey goods, which, in the words of Sir George Rainy, constitute 'the bread and butter part of Bombay's business.[1]

On top of this, a special protective duty of 5 per cent was imposed. The scope of this duty, however, was limited to non-British goods. The Government's contention was that, if the scope of the duty was not limited in this manner, a vast range of goods, in which at that time Bombay was not interested, would be affected to the needless detriment of the consumer; that excluding British goods from the scope of the duty meant excluding just that class of goods which was not in direct competition with Bombay; that the discrimination in favour of Lancashire was purely incidental; and that if England were to try to compete in goods with which Japan had been recently flooding this country, protection could be granted against England also after three years, when the whole position was to be reviewed. But, in spite of the Government's declaration that the preference to British goods was wholly accidental, the suspicion lingers in the minds of many people in India that it was deliberate. The cause of Imperial Preference is not likely to be helped by what public opinion in this country insists on regarding as a backdoor approach to it. The Government would have been well advised in deciding in favour of a uniform duty and accepting the increased burden on the consumer as on the whole the lesser of the two evils.

§11. **Further alterations in the duties.**—Additional protection was secured by the cotton mill industry, first, under the Indian Finance Act of March 1931, which placed an additional duty of

[1] This arrangement by which British as well as non-British plain grey goods were subjected to a minimum duty of 3½ annas per lb. was the result of the Government's acceptance of Mr (now Sir) Shanmukham Chetty's amendment to the original Government Bill. See *India in 1929-30*, p. 254.

5 per cent *ad valorem* on imported cotton piece-goods, and secondly, under the Supplementary Finance Act of November 1931 which imposed a surcharge of 25 per cent on all import duties then existing, thus bringing the import duty to 25 per cent *ad valorem* or 4⅜ annas per lb. whichever was higher, in the case of plain grey goods of British manufacture, and 31¼ per cent *ad valorem* or 4⅜ annas per lb. whichever was higher, in the case of non-British plain grey goods. In the case of other goods the duty was 25 per cent on British goods and 31¼ per cent on non-British goods. The increased duty of 40 per cent on imports of artificial silk piece-goods was also expected to help the Indian cotton textile industry. On the other hand, the new duties imposed at the same time on imported machinery (10 per cent) and other materials were calculated to raise the cost of cloth production at a time when the purchasing power of the people was reduced by the economic depression and fall in prices. Moreover, it was feared that the ½ anna import duty per lb. of raw cotton imposed in November 1931 would handicap the production of finer goods which the mills were trying to build up.

§12. **Second inquiry by the Tariff Board (1932).**—As the protective duties imposed by the Act of 1930 were due to expire on 31 March 1933, the Tariff Board was asked in April 1932 to inquire into the question of further protection to the cotton industry in India. Before the Board could complete its investigations, there was a serious fall in the Japanese exchange (yen) and in the prices of cotton piece-goods imported from Japan, which appeared likely to render ineffective the protection intended to be afforded to the Indian textile industry by the 1930 duties. The Board was therefore directed to make an emergency inquiry (July 1932), as a result of which the import duty on non-British cotton piece-goods was raised from 31¼ to 50 per cent *ad valorem*, and the minimum specific duty on plain grey goods not of British manufacture from 4⅜ to 5¼ annas per lb. with effect from 30 August 1932. These rates were further increased to 75 per cent *ad valorem* and 6¾ annas per lb. respectively with effect from 7 June 1933, in order fully to counteract Japanese dumping. In the meantime the operation of the protective duties imposed in 1930 was extended up to 31 October 1933 so as to enable the Government of India to consider the Report of the Tariff Board on the textile industry. This period was again extended to 30 April 1934 pending the discussion of the question of the conclusion of a new commercial agreement between India and Japan in place of the old Indo-Japanese Convention of 1904, which was formally denounced by the Government of India in April 1933 since under that Convention they were not in a position

to impose safeguarding duties on Japanese goods alone. At last the Indian Legislature passed the Indian Tariff (Textile Protection) Amendment Act, 1934 on 26 April 1934. The Act, which came into force on 1 May, gave effect to the conclusions of the Tariff Board recommending substantive protection to the cotton textile industry, modified in the light of a new Trade Agreement with Japan (1934) and of the unofficial agreement between the representatives of the Indian and the United Kingdom textile industries (known as the Mody-Lees Pact).[1] The Act fixed the rate of import duty on cotton piece-goods, not of British manufacture, at 50 per cent *ad valorem*, subject to a minimum of 5¼ annas per lb. in the case of plain greys.[2] The same Act also extended protection to the sericultural industry (see §38). The life of this Act was limited to 31 March 1939.

§13. **The special Textile Tariff Board (1935).**—In the course of the debate on the Textile Protection Amendment Bill (1934), Sir Joseph Bhore, the Commerce Member, gave a promise to the effect that the tariff rates on British goods would be reviewed on the expiry of the two years covered by the Bombay-Lancashire Textile Agreement. Accordingly, a special Tariff Board, with Sir Alexander Murray as president, was appointed by the Government of India on 10 September 1935 to investigate into and report on the question of protection to the Indian textile industry against imports from the United Kingdom. The Board was asked to recommend duties to equate the prices of imported goods from the United Kingdom to the fair selling prices of Indian goods so as to give the Indian textile industry adequate protection. A special delegation was deputed by the Lancashire industry to place its case before the special Tariff Board in Bombay.

The Board concluded its inquiry in December 1935 and its Report was released for publication in June 1936. Simultaneously, the Government of India announced, by a notification under Section 4 (1) of the Indian Tariff Act, immediate reduction (with effect from 25 June 1936) in the rates of duties on Lancashire piece-goods as recommended unanimously by the Tariff Board. The recommendations of the Tariff Board were:[3]

(i) That the duty on plain grey goods should be reduced from 25 per cent *ad valorem* or 4⅜ annas per lb. whichever was higher,

[1] See ch. xiii.

[2] This was already the rate of import duty in force on non-British goods with effect from 8 January 1934, when the 75 per cent duty was reduced to 50 per cent as a result of the Indo-Japanese negotiations.

[3] *Report of the Special Tariff Board on the grant of protection to the Indian Cotton Textile Industry* (1936), pp. 109-14.

to 20 per cent *ad valorem* or 3½ annas per lb. whichever was higher.

(ii) That the duty on bordered grey, bleached and coloured piece-goods (other than prints) should be reduced from 25 per cent *ad valorem* to 20 per cent *ad valorem*. These reductions were recommended on the ground that the existing duties were excessive for the purpose of securing the protection intended to be afforded by them to similar articles of Indian manufacture.

(iii) That the duty on cotton yarn should remain the same. The Tariff Board made no recommendations regarding printed goods, having regard to the fact that the Indian textile printing industry was still in its infancy. In the case of artificial silk the Board found it difficult to make any proposals because of insufficiency of data.

Lancashire professed to be disappointed that the tariff reductions were not as substantial as the case merited,[1] and that printed goods and yarn were excluded from the new schedule of duties. On the other hand, prominent Indian business men criticized the reduction of duties as being detrimental to the interests of the Indian mill industry which had only a limited scope for its natural expansion in the country. The action of the Government in effecting an immediate reduction in the rates of duty by issuing a Notification without consulting the Indian Legislature was also severely censured. The denunciation of the Ottawa Agreement had again thrown the whole question of inter-Imperial trade relations into the melting-pot, and it was urged that the Government should not have taken such hurried action with reference to an important British import until India had had time to define her future trade policy more clearly. Further, no attempt seems to have been made to obtain any special concessions from Lancashire in return for the reduction of the duties. Since the Mody-Lees Pact terminated in December 1935, it is not even clear whether Lancashire's undertaking to promote the use of Indian cotton in English mills still stands.

The Government, in defence of the action taken by them, argued that the customs revenue from imports of piece-goods was falling off in April and May (1936) mainly owing to the uncertainty regarding the tariffs; that the power granted to the Government under the Indian Tariff Act (1894) could be exercised for reducing as well as increasing the protective duty; and that

[1] Lancashire's contentions were that the Indian industry was no longer an infant industry, that Japan was the real competitor of India, and that Lancashire mills were making increasing use of Indian cotton.

it had been exercised twice before when the duty on non-British (Japanese) piece-goods was increased to 50 per cent in August 1932, and in June 1933 when it was increased to 75 per cent. There was thus precedent for the action taken by the Government.

As regards the statement in the Mody-Lees Pact, that the duty would be reduced along with other surcharges, it was pointed out by the Government of India that after the conclusion of that Agreement this duty was consolidated into a 25 per cent *ad valorem* duty by an amending Act (1934), and therefore it no longer belonged to the category of surcharges.

§14 **The jute industry.**—The first jute-spinning mill was started at Rishra near Serampore in Bengal in 1855, and the first power-loom was introduced in 1859. The progress of the industry was slow during the first thirty years or so and there was scarcely any export trade in jute manufactures. There were, however, not wanting periods of great prosperity enjoyed by the industry falling within this initial stage of comparatively slow development. From 1868 to 1873, for instance, the mills 'simply coined money', and paid dividends ranging from 15 to 25 per cent. This led to the establishment of a large number of new mills and to overproduction. Consequently, profits declined rapidly. The industry passed through a crisis and a number of mills had to be closed down. The jute industry, however, had reached large dimensions and in 1881 there were as many as 5,000 power-looms at work in Bengal. Since 1885 a tendency has been discernible towards a larger output of hessian cloth than gunny bags. Between 1877 and 1915, while sacking looms increased from 2,950 to 17,750 the hessian looms increased from 910 to 22,603, that is there was a growth of 2,400 per cent in hessian looms as against 430 per cent in sacking looms. The War led to a considerable expansion and prosperity of the jute industry, which was called upon to meet the demands in the various theatres of the War for sandbags for the trenches and jute canvas cloth for war purposes such as tent cloth, tarpaulins, waggon covers, etc. This new development was stimulated by the necessity of substituting jute for Russian flax, the supply of which was largely cut off by the overrunning of Russia by Germany in 1915-16.

Barring minor vicissitudes the story of the jute industry has been on the whole one of steady and continuous progress. In 1891 there were 8,000 power-looms at work in Bengal; in 1901, 16,000; in 1911, 33,000; in 1921, 43,000; in 1926-7, 51,061; and in 1930-1, 61,800. The following statistics further bring out the remarkable progress made by the industry, especially during and since the

War. The effects of the world depression on the jute industry are reviewed in a later section.

	Number of mills at work	Authorized capital in lakhs of rupees	Number in thousands		
			Persons employed	Looms	Spindles
Average					
1879-80 to 1883-4 ...	21	270·7	38·8	5·5	88
1899-1900 to 1903-4 ...	36	680	114·2	16·2	334·6
1909-10 to 1913-14 ...	60	1,209	208·4	33·5	691·8
1914-15 to 1918-19 ...	73	1,403·6	259·3	39·7	821·2
1925-6	90	2,134·7	331·3	50·5	1,063·7
1926-7	93	2,119·8	333·6	51	1,083·8
1928-9	95	2,336·7	343·9	52	1,108·1
1929-30	98	2,186·6	343·2	53·9	1,140·4
1930-1	100	2,360·6	307·6	61·8	1,224·9
1931-2	103	2,360·6	276·8	61·4	1,220·5
1933-4	99	2,370·6	257·1	59·5	1,194·4

For many years Great Britain was the only country which manufactured jute goods, Dundee being the principal centre of manufacture. Calcutta has now taken a large part of the trade held by Dundee in the past. The Indian mills' consumption of jute is about five times as much as that of Dundee. The value of jute manufactures exported by sea in 1928-9 was Rs. 56·9 crores, whereas the average value of the export in the period 1879-80 to 1883-4 was only Rs. 1·2 crores. Owing to trade depression the value of these exports declined to Rs. 21·38 crores in 1933-4. Since 1934-5, some improvement has been in evidence, the value of the exports of jute manufactures being 27·94 crores in 1936-7. Nearly two-thirds of the jute grown is now consumed by the Bengal mills as compared with less than half before the War, so that Bengal produces about twice as great a bulk of jute manufactured goods, mainly in the form of gunny bags, hessian cloth and cordage, as all the rest of the world.[1] The demand for jute goods depends on the volume of agricultural production throughout the world, jute manufactures being required for moving agricultural produce from one place to another in the course of internal as well as international commerce. A favourable agricultural season in India

[1] See article on India, *Encyclopædia Britannica*, 14th edn.

leads to a shrinkage of exports of jute manufactures as the demand for packing material increases within the country itself for moving the large volume of crops. So also a fall in external demand as in recent years of economic depression adversely affects exports of jute manufactures. The search for a substitute for jute has not so far met with any marked success, and indeed new uses have been found for jute. The Indian Central Jute Committee, recently established (1936), has decided to undertake research work in jute and jute products with a view to preventing any possible loss of markets.

§15. **Jute and cotton industries compared.**—The jute and cotton manufactures are outstanding examples of the progress of modern large-scale industries in India. The position of the jute industry in international trade is much stronger than that of the cotton industry, jute being an Indian monopoly. As already pointed out, one remarkable contrast between these two most important organized industries of India is that, while the cotton mill industry is almost entirely in Indian hands and financed by capital raised in India, the jute industry owes its origin and development to European—mostly Scottish—enterprise and capital. Another point of difference is that while the cotton industry is decentralized, the jute industry is highly centralized, there being as many as ninety jute mills within a radius of forty miles. Then again an average jute mill is a far bigger unit than an average cotton mill.

As Dr Pillai observes, 'in point of efficient organization, the jute industry is perhaps second to none in India'.[1] This has been facilitated by its highly centralized position. The Indian Jute Mills Association was formed in 1886, to facilitate among other things the adoption of concerted action, as regards introduction of short-time working in the mills to avoid overproduction, etc. The high profits reaped during the War led to overproduction, and after the War was over the industry had to pass through bad times. While the demand slackened, the costs of production increased, owing to a rise in the price of jute and in wages.[2] In 1921-2 the Association invited an American business expert to advise it on the possibility of forming a jute trust with a view to exercising some control over the production and price of jute. The termination of the slump, however, led to the abandonment of the project for the time being. The Calcutta Jute Dealers' Association looks after the common interests of its members as dealers in jute for local consumption.[3]

[1] P. P. Pillai, *Economic Conditions in India*, p. 175.
[2] For a recent survey of the jute industry see Matheson, op. cit., ch. v.
[3] *Indian Year Book* (1937-8), p. 703.

§16. **The jute industry during the depression.**—The jute mill industry has by no means escaped from the effects of the recent depression, which has affected almost every industry to a greater or less extent. The jute industry has suffered and is still suffering from declining prices, presence of heavy stocks at the principal consuming centres, frequent labour troubles, etc. But on the whole it has faced the difficulties of the post-War depression much better than the Bombay cotton mill industry. It has thus been rewarded for its care in maintaining adequate reserves and its systematic adoption of short time when necessary. During the ten years, ended in March 1936, a policy of curtailment of output was continuously in force. The mills in the membership of the Association worked forty hours a week and with a certain percentage, varying from fifteen in 1931 to ten in 1935, of looms sealed. The lowering of the percentage of the looms sealed was caused by the competition of the mills who were not parties to the Restriction Scheme as also by the improved outlook in trading conditions and the competition from other manufacturing centres. No agreement has so far been reached with the non-Association mills. The year 1937 was critical for the jute manufacturing industry, owing to unrestricted production and labour trouble. Prices tended to decline as the year progressed.

§17. **Iron and steel industry.**—The iron and steel industry has a better claim than almost any other to be called a basic or 'key' industry, and its national importance cannot be exaggerated. A striking contrast between the industrial revolution of India and of England is that, while the revolution began in India with the application of steam to the textiles, it began in England with the development of the essential iron and steel industries. The new industrial system in England had a solid foundation in the firm establishment of the iron and steel industry and the ancillary mechanical engineering industries. But such a development has not marked the course of the revolution in India. Until recently Indian industries have relied almost exclusively upon imported machinery and machine tools, and hardware goods in general. However, both the Government and the public have at last awakened to the extreme importance on national grounds of the iron and steel industry, and certain important steps to be alluded to presently have been taken to ensure its rapid progress.

Pioneer attempts to introduce modern methods for the manufacture of pig-iron and steel were made as early as 1830 in the South Arcot district. They were all destined to failure until the Barakar Iron Works, which were acquired in 1889 by the Bengal Steel and Iron Company, were started in 1874 in Bengal on the

Jherria coal-fields. The Bengal Steel and Iron Company began to show a profit only from 1899. The annual production at the beginning of the present century was about 35,000 tons. An attempt to make steel resulted in heavy loss owing to the low price of imported steel, small orders for numerous sections, the inferior quality of pig-iron then produced for steel-making and dependence on imported supplies of fire-bricks and ferro-manganese.[1] A new era in the history of the Bengal company, however, was opened in 1910 with the beginning of the exploitation of a new source of iron ore in the Singhbhum and Manbhum districts.

The next important stage in the history of the industry was ushered in by the formation of the Tata company. The company was established at Sakchi in the Singhbhum district by the late J. N. Tata in 1907, and the construction of the works began in 1908. Pig-iron was first produced in December 1911, and steel—for the first time in India in modern times—in 1913; and by 1916, under the stimulus of the War demand, the whole plant was in full production. Thus after a somewhat anxious period, which was to be expected in a pioneer enterprise of this character, especially in the face of unfettered foreign competition, the works were placed on a sound footing and proved of invaluable assistance in prosecuting the War by providing large quantities of rails and sleepers for military railways in Mesopotamia, Palestine, East Africa and Salonika. In 1917 a large scheme of extension was mooted and completed in 1924, the delay being the result of difficulties of the War and the post-War periods, such as that in connexion with the import of the necessary machinery. The old plant turned out finished steel products, such as rails, heavy structurals (beams, angles, channels), bars, light structurals, light rails and fish-plates. The additional products which the new plant, which has been in operation since 1926, turns out, are plates, sheets (black and galvanized), sheet bars and sheet sleepers.[2] The success of the Tata enterprise has called into existence some new companies, such as the Indian Iron and Steel Company formed in 1908 by Messrs Burn & Co. of Calcutta, at Hirapur near Asansol; the United Steel Corporation of Asia started in 1921 by Messrs Bird & Co. of Calcutta, at Manoharpur; the Eastern Iron Company and the Mysore State Iron Works started at Bhadravati in 1923. It may be noted that at the last named works blast furnaces are fired by charcoal.

The expansion of the industry is reflected in the figures of

[1] *Industrial Handbook of the Munitions Board*, pp. 138-9.

[2] *Report of the Tariff Board on the Steel Industry* (1924), pars. 14-15.

production and imports. The production of pig-iron advanced from 35,000 tons at the beginning of the century to 162,282 tons in 1914; 232,268 tons in 1919 and 1,376,000 tons in 1929-30. In 1930-1 it declined to 1,140,000 tons owing to reduced exports. In 1936-7, the production of pig-iron stood at 1,557,000 tons and 574,000 tons valued at Rs. 1,29 lakhs was exported, Japan being the principal customer. Next to Japan, the United Kingdom and the U.S.A. are substantial buyers of Indian pig-iron. The quality of the pig-iron turned out is fully equal to that of the continental product; indeed the imports of pig-iron are now almost negligible being 1,600 tons in 1936-7, the entire quantity having been received from the United Kingdom.[1] The production of steel advanced from 139,433 tons in 1916-17 to 599,565 tons in 1927-8, and that of finished steel from 98,726 to 428,654 tons during the same period. The production of steel ingots was 861,000 tons and that of finished steel 692,000 tons during 1936-7. The present world-wide campaign of rearmament has given an impetus to the steel and iron industry. India has taken advantage of the world situation to consolidate her own industry.

India is still dependent to a very large extent upon foreign iron and steel in spite of her own increasing production. The pre-War average of India's imports of iron and steel was 808,000 tons valued at Rs. 12·48 crores. During the five War years the average imports declined to 422,000 tons valued at 10·11 crores. It was during this period that the Tata company increased its output and supplied the Government with war materials. During the post-War years the imports steadily increased from the post-War average of five years of 661,000 tons valued at Rs. 21·38 crores to 968,000 tons in 1929-30 valued at Rs. 17·16 crores. These increased imports in spite of increasing home production were attributed to increasing consumption in India by railways and other public works, as also by the building trade. This post-War increase in imports furnished an added plea for protection being granted to the industry. Owing to the economic depression prevalent throughout the world and increase in home production imports have declined in recent years. After having fallen to 329,000 tons valued at Rs. 5·53 crores in 1933-4, the imports increased to 449,000 tons valued at Rs. 7·22 crores in 1935-6. They again declined to 363,000 tons valued at Rs. 5·94 crores in 1936-7.

Before turning to the question of protection let us refer to some striking developments in connexion with the establishment of subsidiary industries, including those utilizing by-products, in the

[1] *Review of the Trade of India*, 1936-7, p. 50.

neighbourhood of Sakchi (renamed Jamshedpur at the end of the War). The following are some of the various manufactures which are produced under the Extension Scheme :—steel tubes, tinplate, enamel ware, wire, nails, railway wagons, tea and jute mill machinery, agricultural tools, galvanized products, iron and steel castings, heavy chemicals, sulphuric acid, nitric acid, fertilizers, lime, ammonium sulphate, etc. Various manufacturing companies have already been established for this purpose. Jamshedpur and the surrounding territory are thus developing into a veritable beehive of modern industries.

§18. **Grant of protection to the steel and iron industry.**—The policy of discriminate protection adopted by the Assembly early in 1923 was brought into operation for the first time in India in the case of the steel and iron industry, as recommended by the Fiscal Commission. A Tariff Board was accordingly constituted and was entrusted with the task of investigating the claim put forward by the Tata Steel and Iron Company for protection to the steel industry. The company proposed that the existing 10 per cent *ad valorem* import duty should be raised to 33⅓ per cent in order to give the industry adequate protection against the dumping of foreign steel and iron, which was stimulated by the depression in the world trade, depreciated continental exchanges and the long start which the well-established foreign industry had obtained over the infant industry in India. They further drew attention to the opinion of the Fiscal Commission that the prosperity of such an important basic industry was essential from the point of view of national safety and development, and recalled the great services rendered by them to the Government during the late War.

The Board after a careful inquiry came to the conclusion that the case for protection was not ill-founded, and that development had been recently hindered by severe competition from abroad coinciding with a large scheme of expansion set on foot by the Tata company. The Board held that the industry satisfied all the conditions laid down by the Fiscal Commission. India possesses great natural advantages for the manufacture of steel owing to the richness and abundance of iron ore deposits in the Singhbhum and Orissa iron belts and the comparatively short distance which separates them from the coal-fields. The quantities of coking coal available are sufficient for the requirements of the country. Similarly, the supplies of limestone and dolomite are ample and good enough for most purposes. Most of the other raw materials required, such as manganese and materials for refractory bricks exist in India in sufficient quantities. The industry also possesses the advantage of a large and expanding home market. In respect of labour, however,

'India suffers under a disadvantage inevitable in any country mainly agricultural, and where industrial experience and training has still to be acquired', rendering it necessary to import at present skilled supervisors from America and Europe. This is, however, a temporary handicap which will eventually disappear. The Board held that, unless protection was given, there was no hope of the industry developing for many years to come, and there was a serious danger that it might cease altogether. It was also thought that probably the cost of steel production would fall substantially in the next three or four years and that the industry would be able to do without protection at no very remote date. The Board agreed that it was also an essential industry for military purposes, and was, therefore, specially entitled to protection. The burden on the consumer was expected to be temporary and widely diffused.

The Steel Protection Bill incorporating the recommendations of the Board was considered and passed by a special session of the Indian Legislature in May and June 1924. The duties on certain articles manufactured from steel were increased, and bounties (amounting in all to about Rs. 242 lakhs during 1924-7) were granted on heavy steel rails, fish-plates and railway wagons manufactured in India. The duties on steel bars were fixed at Rs. 40 per ton, and on sheets at Rs. 30 per ton. At the end of the period, the bounties and duties alike were to be subject to revision.

Subsidiary measures of protection had to be taken to safeguard the interests of such of the industries as make use of steel as their raw material. An increase in its price due to protection was likely to be detrimental to many branches of the engineering industry at a time when it was holding its own with difficulty in the face of foreign competition. The Tariff Board made certain recommendations to meet this aspect of protection to steel, which were accepted by the Government and the Assembly. The engineering industry was protected by higher duties on imported fabricated steel with certain exceptions.

The protection granted to the steel industry was, however, soon afterwards largely nullified by the fall in the price of continental steel and the maintenance of the exchange in the neighbourhood of 1*s*. 6*d*. Further protection was granted in 1925, by extending larger bounties.

§19. **Statutory inquiry into the steel industry (1926-7).**—As provided for by the Steel Protection Act, 1924, which was due to expire on 31 March 1927, the Tariff Board carefully examined the position of the industry in 1926 and recommended the continuance of protection on certain lines for a further period of seven years.

The industry was now to receive protection in the form of increased duties on import and not by bounties on production, since the latter would be too costly to maintain over a period of seven years, at the end of which a fresh inquiry was to be made in order to ascertain what kind and amount of protection might still be necessary.[1] Accordingly, a Bill was introduced in the 1927 Delhi Session and came into force on 1 April 1927. It provided for an imposition of different rates on certain iron and steel articles, with a basic duty on articles of British manufacture and an additional duty on those of non-British origin. There was a heated debate in the Assembly on the proposal to differentiate between standard and non-standard steel, that was, practically, between British and continental steel. The Government, agreeing with the Board, held that this was necessary in order to secure a fair distribution of the burden on the different classes of the consumers and to ensure stability to the scheme of protection. The opposition suspected that the Bill contained the principle of preference to British steel, to which they were opposed.

The Tariff Board submitted its second Report, which concluded the statutory inquiry into the steel industry, in June 1927. In March 1928, the Government introduced the Steel Protection Bill in the Assembly to give effect to their decisions on the Board's Report, which passed into law as the Steel Industry (Protection) Act of 1928

§20. **Recent measures of protection to the steel and iron industry.**—On the representation of the firm of Indian Steel Wire Products Ltd., Tatanagar, protection was restored by the Wire and Wire Nail Industry (Protection) Act, 1932, passed on 5 March 1932, on the recommendation of the Tariff Board. A protective duty of Rs. 45 per ton on wire and wire nails was imposed up to 31 March 1934 as there was an early prospect of the firm supplying itself with indigenous raw material. The Indian Tariff (Ottawa Trade Agreement) Amendment Act, 1932 which came into force from 1 January 1933, gave effect to the tariff changes necessitated by the trade agreement made by the Government of India and His Majesty's Government in the United Kingdom at the Ottawa Conference held during July and August 1932 and the supplementary agreement regarding iron and steel in the September following. In the class of iron and steel goods, the preference extended only to those commodities not subject to the protective duties and in the class of machinery only to those articles which

[1] See *Report of the Tariff Board Regarding the Continuance of Protection to the Steel Industry* (1927), par. 167.

paid the ordinary revenue rate of 25 per cent *ad valorem* and not to those which in the interest of agriculture and industries were free of duty or were subject only to the temporary duty of 10 per cent *ad valorem.* The supplementary agreement provided for the adjustment of the Indian import duty on galvanized sheets as follows: Rs. 30 per ton on sheet made in the United Kingdom from Indian sheet bar; Rs. 53 per ton on sheet made in the United Kingdom from other sheet bar; Rs. 83 per ton on sheet not made in the United Kingdom. The period of operation of the protective duties imposed by the Act of 1927 and the two Acts of 1932 was extended up to 31 October 1934. Meanwhile, in accordance with the Steel Industry (Protection) Act, 1927, the whole question of the renewal of protection was reviewed by the Tariff Board. The Iron and Steel Duties Act, 1934, gave effect on and from 1 November 1934, to the protective measures recommended by the Board. As the recommendations of the Board involved considerable reduction in the level of import duties in certain important cases with a resultant reduction in the revenue derived from customs, it was found necessary to impose as a revenue measure an excise duty of Rs. 4 per ton on the production of steel ingots in British India, and to impose a countervailing customs duty on steel ingots. This countervailing duty is additional to the protective duties recommended by the Board and alternative to the *ad valorem* revenue duties on articles in respect of which protection had not been proposed.

On the whole, we may approve of the general policy followed in regard to the steel and iron industry since 1924. Although it is true that without the timely intervention of the State the industry could not have survived the shock of post-War competition, the protection offered between 1924 and 1927 was not quite adequate and the Tata Steel Company was barely able to pay its way. In spite of certain unfavourable circumstances, however, the industry made appreciable progress ' as evidenced by increase of output, improvement in the efficiency of labour, reduction in the number of foreign hands, and considerable reduction in works costs ' and also by ' considerable improvement in the conditions of labour, especially in respect of wages, housing and various amenities of life '.[1] The decision to continue the protection until the year 1941 by renewal of the protective measures adopted in 1934 would thus seem to be abundantly justified.

[1] See H. L. Dey's article, ' Protection of the Steel Industry, 1924-7 ' in *Indian Journal of Economics*, July 1928.

§21. **Tanning and leather industry.**[1]—India possesses a large supply of hides and skins. The cow-hides, 'the East India kips' as they are called, goatskins, buffalo-hides and sheepskins, etc., may be regarded as the by-products of her agricultural industry. Previous to the War, India sent large exports of raw hides, especially to Germany and Austria, which were valued at Rs. 7·17 crores in 1913. In the same year, raw skins valued at 3·4 crores were exported, mainly to the U.S.A. There was a large demand in foreign countries and high prices were offered. The War brought about important changes in the Indian tanning industry and in the export trade in hides and skins, partly because of the cutting off of the enemy markets and partly owing to the control exercised by the Government.

There has long existed a considerable indigenous tanning industry in the country under which locally available tanning materials are used for curing and tanning hides mainly to meet the local demand for inferior kinds of leather. But the most striking changes have taken place in the European methods of tanning which were first introduced by the military authorities to manufacture superior leather suitable for harness and other military requirements; and tanneries usually followed the establishment of arsenals. At Cawnpore, a further step in production was taken in 1860 when the Government Harness and Saddlery Factory was set up. Shortly afterwards, Messrs Allen and Cooper established the Army Boot and Equipment Factory and received at the outset considerable financial assistance from the Government. 'A marked degree of success has attended the efforts to develop the leather trade in Cawnpore, and, up till the time of the outbreak of the War, the factories which have come into existence, though largely dependent on the army for orders, were by no means apanages to the military department.'[2] The Western India Army and Equipment Factory was started at Sion in Bombay by Adamjee Peerbhoy. A few more factories were established at various centres where the production of finished goods was attempted. Although considerable use of machinery is made in European tanneries and leather-working factories, it was until recently conspicuous by its absence in the Indian tanneries except in the Cawnpore and Sion factories and

[1] The Hides Cess Inquiry Committee estimate the value to India of this industry taken as a whole (that is the raw stock and leather trades and the leather, leather-working and allied industries) at about forty to fifty crores of rupees. It provides employment to large numbers of men and is a factor in the economic well-being of millions of India's depressed classes.—*Report of the Hides Cess Inquiry Committee* (1930), par. 158.

[2] *Industrial Commission Report*, Appendixes, p. 57.

the Madras Tannery, which produced the whole of the half-tanned leather and skins that loom largely in the export trade of the country. Before the War, the bulk of the export trade in tanned hides and skins was confined to the south of India where the bark of *cassia auriculata*, known in Madras as *avaram* and in Bombay as *tarwad*, is obtainable, Madras having by far the larger number of tanneries.[1]

§22. **Effects of the War on the tanning and leather industry.**— The tanning and leather industry underwent a remarkable transformation during the War. The Indian Munitions Board directed its activities towards increasing the outturn and regulating the production of those kinds of leather which possess a special value as war material. The most important development was connected with the great increase in the production of the rough-tanned cow-hides, known as the East India tanned kips, from the Madras and Bombay tanneries. The value of these kips for making the 'uppers' for the army boots was realized during the War and the Government assumed complete control of the trade, purchasing in India the whole of the available supply for export direct to the British War Office. Whereas 194,763 cwt of tanned hides valued at Rs. 1·75 crores was exported in 1913, in 1917-18, 361,674 cwt valued at Rs. 4·86 crores was exported. In addition to the export trade in East India kips, Indian tanneries produced, during the War period, greatly increased quantities of leather accoutrements of all sorts and boots for the army in India and the Indian expeditionary forces. Thus under the direction of the Munitions Board the Government gave a great stimulus to the tanning industry, and the output of the annually produced boots and shoes was twenty times bigger at the end of the War than before it. Under the system of Priority Certificates the Munitions Board endeavoured further to stimulate the manufacture in India of certain classes of leather goods previously imported from abroad, such as roller skins, picker bands, leather belting and the raw hide pickers required by the textile mills.[2]

The chrome process of tanning which enables superior leather to be produced has made very slow progress in India, though it was thoroughly well established in America by about 1895. The Government of Madras did valuable pioneering work from 1903 to 1911 to demonstrate that chrome tanning could be successfully established in this country. It is, however, to be regretted that the Government had to sell the factory in response to protests from the Upper India and Madras Chambers of Commerce who raised

[1] Matheson, op. cit., ch. vi.

[2] *Industrial Handbook*, pp. 160-8.

the cry that private trade was invaded. Upon the outbreak of the War, however, progress was more rapid; and Indian chrome leather hides found a profitable market in Great Britain. There are several difficulties experienced in connexion with the development of chrome tanning in India, such as the highly technical processes requiring chemical knowledge and costly mechanical equipment. A considerable proportion of Indian cow-hides and goatskins is, however, eminently suited to this class of work, and promising developments may be expected under the guidance of the expert tanner whose services have been secured by the Government for the development of the tanning industry.

§23. **Protection to the tanning industry.**—In 1919, the Indian Tariff Act of 1894 was amended and an export duty of 15 per cent on hides and skins was levied with a rebate of 10 per cent on hides and skins exported to other parts of the Empire and actually tanned there. The duty was imposed as a measure of protection to the Indian tanning industry which had received a great stimulus from Government patronage during the War but which was likely to dwindle with the fall in military needs unless some other support was given to it. As the Indian tanneries, however, could only deal with a small proportion of the total supply of hides and skins in the country, the rebate was defended as a measure of help to the tanning industry within the Empire, so as to divert the tanning of Indian hides from Germany to the British Empire. The experiment, however, failed to achieve either of the objects. The Indian tanning industry did not succeed as expected. There was a fall in the export of hides from India to half the pre-War level and the greater part of the trade again passed to Germany. The Fiscal Commission condemned the duty as wrong in principle, on the ground that if protection was needed, it should have been given through an import and not an export duty. The Government of India, impressed with the defects of the duty, reduced the rate to 5 per cent and abolished the 10 per cent rebate in 1923, the retention of the 5 per cent duty being justified on the ground of revenue need. The majority of the Taxation Inquiry Committee, however, agreeing with the Fiscal Commission advised its early abolition. Dr R. P. Paranjpye and Sardar Jogendrasingh held that the experience of the preceding few years was not conclusive owing to the abnormal conditions of the War and advocated a determined policy of protection for the Indian tanning industry and the retention of the export duty. The Taxation Committee, however, recommended the retention of the duty on skins which enjoy a good reputation in the world market and were not injuriously affected by the duty. Accordingly, the Finance Member proposed the abolition of the 5

per cent export duty on raw hides in the Finance Bill of 1927. The Assembly, however, rejected the proposal, to the great disappointment of the exporters, as it was of the opinion that the interests of the Indian tanning industry would be injured by such a course.

The Government of India appointed in September 1929 the Hides Cess Inquiry Committee to inquire into and report on the advisability of imposing a cess on the export of raw hides and skins and of constituting a Committee to administer such a cess on the lines of the Indian Central Cotton Committee for the benefit of the industry as a whole. Although the Government Resolution announcing the appointment of the Inquiry Committee contained the remark that 'a satisfactory solution of the difficulty might be found in the replacement of the export duty by an export cess', the Committee held (one member, Mr E. L. Price, dissenting) that the question of the export duty was not specifically referred to them and found members' views irreconcilable on it. They recommended the imposition of a 1 per cent *ad valorem* cess on the export of raw hides and raw skins, the proceeds to be spent on the improvement of raw stock and of the tanning and allied industries. The cess fund was to be administered by a Cess Committee consisting of the representatives of growers, dealers, shippers of raw stock, the tanning industry, co-operative societies, Indian States and a few Government officials. It was proposed that, pending a decision on the separate question of the export duty, the total taxation of raw stock should remain as it was.[1]

The 5 per cent export duty on raw hides was abolished by the Finance Act of 1934 owing to the decline in the export trade in raw hides with Germany, while the export duty on raw skins was abolished by the Finance Act of 1935 in order generally to help the revival of the export trade of India (see also ch. xi).

The claims for protection of the Indian tanning and leather manufacturing industry as a key industry deserve to be carefully considered. Alongside of protection, however, there is considerable scope yet for internal improvement, for the principal difficulty which the industry has to face is the lack of organization and expert skill. Two factors have, however, operated in favour of the tanning industry in India in recent years. There has been a noticeable increase in the consumption of leather, particularly for footwear, water bags, harnesses, etc. Secondly, with the increased

[1] See *Report of the Hides Cess Inquiry Committee* (1930), pars. 112, 117, 122, 126, 127.

consumption of meat in Central Europe there is a considerable supply of domestic hides at prices so low that there is little inducement for Indian hides to be exported. This has made it possible for the Indian tanners to select hides and still pay for them prices higher than those ruling in Europe.

§24. **Chemical industries.**—' In a modern state the development of chemical industries on a scale that renders them an important factor in the economic life of the State—as they are in England, Germany and America—necessitates the provision of certain essentials at sufficiently low rates.' These essentials are, at first, the fundamental heavy chemicals, especially sulphuric and hydrochloric acids, lime, caustic soda, sodium carbonate, nitric acid, etc. They are used in the production of other chemicals from indigenous sources also for refining the various natural products or materials derived from such products. Thus large quantities of sulphuric acid and alkali are required for refining fixed and mineral oils. The other two essentials are (i) fuel for power, heating purposes and metallurgical operations; and (ii) chemical plant.[1]

Though the War gave a considerable stimulus to many of the chemical industries, India still depends largely upon foreign chemicals. Thus in 1936-7 she imported chemicals of the value of Rs. 272 lakhs, as compared with the pre-War average of Rs. 90 lakhs. However owing to the great variety and the relatively small quantities of each kind consumed in India, under peace conditions local manufacturers have so far confined their attention to a few heavy chemicals, such as sulphuric, hydrochloric and nitric acids, which are largely in demand, the heavy sea freights on acids serving as protection. The absence of this natural protection, however, in the case of salts derived from sulphuric acid, has prevented their manufacture except on a small scale. Simple extracts and drugs are also manufactured on a small scale. Since the end of the War the chemical industries have shown indifferent progress.

India's sources of raw materials for heavy chemicals are not deficient if only the various mineral ores are properly treated. Her varied mineral wealth in sulphide ores, saltpetre, alum salts, limestone, magnesium, etc. has been already indicated. Striking success has already been achieved in the manufacture of sulphuric acid which is a most important key industry for all chemical industries, so much so that its production is suggested as a test for judging the wealth of a country. There was a large demand for it, especially during the War, for explosives. The industry is already established in India, but the promise held out by the project of

[1] *Industrial Handbook*, p. 58.

smelting at Singhbhum the Burmese zinc concentrates for the production of spelter (zinc) has not been fulfilled. The Eastern Chemical Co. Ltd., Bombay, put up a case in 1928 before the Tariff Board for a substantial subsidy for the manufacture of sulphuric acid. The industry has at present to face the keen competition of powerful European syndicates, Germany and the United Kingdom being the most serious rivals.[1] As regards nitric acid, the home production cannot yet be regarded as adequate. It was stated by the representatives of the chemical industries before the Tariff Board that the establishment of the new refinery for H. M. Mint, Bombay, would require about 200 tons of nitric acid annually which is double the present output. Here again Germany is the keenest competitor. The establishment of a plant for the recovery of the by-products in coking, such as tar and ammonia, has recently been undertaken.

The other essentials of chemical industries are fuel and plant. The fuel situation has already been examined and it has been shown how Indian coal deposits are unevenly distributed. Coal as fuel is for instance cheap in Bengal, which is, therefore, a convenient centre for certain chemical industries; not so South India, however. India's hydro-electric schemes are not as highly developed as those in Europe and America. Further attempts are necessary to supply cheap electric power for the development of electro-metallurgical and electro-chemical industries. The special plant required by the chemical industries was imported before the War, but much of the simpler plant can be locally manufactured and a start has already been made in this direction.

§25. **Protection to the heavy chemical industry.**—This question was referred to the Tariff Board in July 1928. The Board concluded that the claim of the chemical industry for protection rested primarily on its supreme national importance. It was a key industry whose products were used in almost all industries, it was indispensable for national defence and it provided an essential foundation for chemical research in industries and agriculture. The industry substantially fulfilled the conditions laid down by the Fiscal Commission and had made out a case for protection. This was to be given generally in the form of specific duties. In the case of epsom salts and zinc chloride the specific duties proposed were equivalent to *ad valorem* duties of 44 per cent and 34 per cent respectively. On the other chemicals the duties represented substantially the existing level of revenue duties. At the expiration of a period of seven years of protection, a fresh inquiry was to be held as in the

[1] See *Report of the Tariff Board on the Heavy Chemical Industry*, par. 72.

case of the steel industry. A bounty was to be granted for the manufacture of superphosphate which is used as an artificial fertilizer. The Board recommended reduction of railway freights with a view to the formation of a large-scale chemical industry in India. Having regard to the overproduction in Europe and manipulation of prices by powerful European combines, the Governor-General-in-Council was to be empowered to impose additional duties on being satisfied that chemicals were entering India at such prices as were likely to render the protection given ineffective.[1] After a considerable delay the Heavy Chemical Industry (Protection) Act, 1931, which was passed on 1 October 1931, gave effect to some of the recommendations of the Tariff Board. It removed magnesium chloride from the free list and imposed on this and certain other heavy chemicals protective duties at various rates. These duties were to remain in force till 31 March 1933 except in the case of magnesium chloride. The protective duty on the latter was to operate up to 31 March 1939 and could be enhanced if necessary. The question of continuance of protection to the magnesium chloride industry has recently (December, 1937) been referred to the Tariff Board.

§26. **Oil-milling industry.**—We may here say something regarding the oil-milling industry. Though India produces a variety of oil-seeds, she is mainly a seed-exporting country and has not properly developed the manufacture of finished products such as refined oils and oil-seed cakes. In Europe and America, efficient plant and improved processes are used. In India we still do our oil-pressing mostly by the archaic method of the bullock and the *ghani*, which leaves a large percentage of oil in the cakes, impairing their usefulness for cattle feeding or as fertilizers. In addition to this the oil is usually highly coloured and impure and fetches comparatively low prices in the market.

There has been in recent years a great increase in the number of oil-mills worked by steam or other mechanical power, especially in the case of mustard oil, castor oil, and groundnut oil. There are several difficulties experienced by the oil-milling industry in India. In the first place, oil-seeds are admitted duty free into most countries, whereas finished products are subjected to a tariff duty. Secondly, freight on seed is lower than on oil and even on cakes. Moreover, the Indian cultivator is prejudiced against machine-made cakes as cattle food or manure. Lastly, India cannot absorb today all the cakes or meal manufactured for fertilizers and feeding, though

[1] See *Report of the Tariff Board on the Heavy Chemical Industry*, pars. 74, 137.

her interests require an increase in this demand. It is, however, both unsound and uneconomic for India to export her oil-seeds instead of manufacturing the oils and oil-cakes herself. She is thereby deprived of the manufacturer's profits, and Indian agriculture of cattle food and manure of high value. Moreover, vegetable oils have several important uses and play a geat part in the economic life of a civilized community. Vegetable oils and tallow are necessary for the manufacture of soap, glycerine, and for culinary and lubricating purposes, etc. Since the War considerable attention has been given to the possibility of developing the Indian oil-milling industry on a large scale. Persistent effort to place the industry on a sound footing will undoubtedly be crowned with success.

§27. **Paper-making.**—The production of machine-made paper in India in modern times apparently dates from 1870 when the Bally Mills were established on the Hooghly. Its neighbourhood is still the principal centre of the industry. The Titaghur Paper Mills were established in 1882 and absorbed in 1903 the Imperial Paper Mill, which had been started at Kankinara in 1892-4. The Bally Mills after an apparently promising career for some years were liquidated in 1905. For thirty years after 1892 no new paper mill was established on the Hooghly, but in 1922, the Indian Paper Pulp Company, which was formed in 1918 for the production of pulp and paper from bamboo, commenced manufacture of paper in the Naihati Mill. As regards the up-country paper mills the oldest of them, the Upper India Couper Mill, was established at Lucknow in 1879. In 1885 the Deccan Paper Mill Company was formed and started work at Poona in 1887. The most important up-country paper mill at present is at Raniganj. It was started in 1891 by the Bengal Paper Mill Company formed in 1889. There are three other small paper mills in India, two at Bombay and one at Punalur in the Travancore State. In 1927-8, the Carnatic Paper Mills started operations at Rajmahendry for making paper from paddy, straw and bamboo. The Punjab Paper Mills Company has obtained a large concession with regard to *bhabbar* grass in the Punjab for its factory near Saharanpur. Barring these two new mills, the full annual capacity of the old nine mills was placed by the Tariff Board at 33,000 tons, which would be raised to 43,000 tons if the new mills were included. In Assam, a new company has been formed and at Chittagong a new factory for manufacturing paper pulp from bamboos has been opened. The Indian production of paper amounted to 971,000 cwt in 1936-7 as compared with 804,000 cwt in 1932-3. In the same year there were altogether eleven paper mills in India, namely four each in Bengal and Bombay, and one

each in the United Provinces, Madras and Travancore. The Tariff Board estimated the market open to the Indian paper-maker at the present rate of consumption at about 50,000 tons out of a total annual consumption estimated by the Board at 100,000 tons. Thus when the full production is attained by the existing mills they will be supplying four-fifths of the whole demand and, therefore, the market which the Indian mills can capture is not large enough to admit of any great development of the industry. Until the demand in India for finer and more expensive paper increases substantially no Indian mill will be able to compete with the European mills which specialize in the finer qualities.

The staple material of the paper-maker in India has hitherto been *sabai* grass which grows abundantly in northern India and is like the esparto grass in Europe. Indian wood has not yet been used to make paper, and pulp is imported from Europe. For the cheaper kinds of paper, rags, hemp, jute waste and waste paper are used. The Indian Paper Pulp Company is a notable exception and makes paper from bamboo pulp. *Sabai* grass grows in scattered tufts intermixed with other vegetation and is affected by unfavourable seasons. The yield of bamboo per acre is larger than of grasses and the cost of production also smaller. Bamboo is easily available in Burma, Bengal and south-west India. For the great bulk of the paper consumed in India, bamboo fibre is quite good enough, though as a paper-making material bamboo is inferior to *sabai* grass in strength and durability. But as already pointed out, the Indian demand for the better qualities of paper is small. Bamboo has been the subject of a good deal of attention from this point of view since 1875. In 1905 the possibilities in Burma were investigated by a special expert, and a pulp expert was appointed subsequently at the Forest Research Institute. As a result of the researches carried out there, great expectations have been raised regarding the future of the bamboo paper pulp industry, and it is believed that, if the Indian bamboo and grasses could be successfully utilized for paper pulp, the anxiety regarding a world shortage of paper could be largely removed. However although the outlook in respect of raw material is promising, the industry is at present working under certain disadvantages, such as the high cost of chemicals, heavy transport charges for coal, and severe foreign competition from Scandinavia, Germany, the United Kingdom, Austria, Japan, and the U.S.A. Imports of paper have been increasing in recent years. The imports of paper and pasteboards combined amounted to 2,718,000 cwt valued at Rs. 246 lakhs, in 1936-7.

§28. **Protection to paper.**—The Tariff Board was asked to consider the claim to protection made on behalf of the paper and paper pulp industry in April 1924. The Board's investigation justified the hope that the manufacture of paper pulp and paper from bamboo could be successfully developed in India. They recommended a protective duty of 1 anna per lb. for five years on certain classes of writing and printing paper competing with Indian paper and a loan or guarantee in respect of both principal and interest of Rs. 10 lakhs to the Indian Paper Pulp Company at Naihati to enable them to purchase more plant and so test the sulphite process on a commercial basis; and the grant of similar assistance to any mill which was prepared to test the soda process.

In 1925 the Bamboo Paper Industry (Protection) Act was passed providing for the imposition of a protective duty of 1 anna per lb. for seven years until 31 March 1932, so as to secure a firm basis for the industry. The Bamboo Paper Industry (Protection) Act of 1932 renewed the protective duty up to 31 March 1939 as recommended by the Tariff Board, which found that considerable progress had been made in developing the bamboo paper industry, that ample supplies of raw material were available at lower prices than in 1925, and that the cost of production in Indian mills had been materially reduced during the period of protection. The same Act imposed a new protective duty of Rs. 45 per ton on imported wood pulp to supply a definite stimulus to the manufacture and use of bamboo pulp. The industry has not, so far, made any rapid progress by way of new mills. It is understood, however, that a mill is about to be started in Bangalore and another one at Hyderabad. The question of continuing protection to the paper industry has recently (December, 1937) been referred to the Tariff Board. The Board will also have to investigate the question of protection to paste-board, cardboard, etc., in view of the fact that the raw material in the shape of bagasse is now available in sufficient quantities owing to the expansion of the sugar industry.[1]

§29. **Glass manufacture.**—Glass-making is a very ancient industry, and reference is made to it by Pliny who speaks of the superior 'Indian glass' made from crystals. However, no traces survive of the ancient industry, and all that is certain is that in the sixteenth century it existed as an established industry but had not advanced beyond the stage of producing very inferior material utilized for the manufacture of bangles and, to a small extent, small bottles and flasks. Then as now there was a large demand

[1] *The Times of India*, 24 December 1937.

for bangles in the country. More recently, between 1892 and 1893, five glass factories of the modern type were established, but they were all wound up sooner or later. Those started under European management struggled hard and survived longer, but the last of them failed in 1908. Another European attempt, also unsuccessful, was made in Madras in 1909.

The glass industry, however, seems to have a peculiar fascination for Indians, for, in spite of the previous failures, as many as sixteen factories on a small scale were started during the swadeshi period 1906-13 and were the products of pure Indian enterprise. In some cases European trained glass-workers assisted them and in others they relied on Japanese workers under the control of Indians who had been to Japan to learn the methods. Only three of these factories, however, were in operation on the eve of the War, and none of them was making a commercial profit, though the Talegaon factory in the Poona district, aided by the Paisa Fund, was paying its way on the somewhat peculiar and non-commercial lines on which it was run.

Two well-defined classes of the industry in its present stage can be distinguished: (i) the indigenous cottage (bangle-making) industry; and (ii) the modern factory industry. The indigenous industry is spread all over India but is chiefly concentrated in the Firozabad district of the United Provinces and the Belgaum district in the south. There is a large colony of bangle-makers and about sixty bangle factories in Firozabad. The Firozabad industry is mainly engaged in making cheap bangles from glass cakes or blocks made in larger factories. It supplies nearly one-third of the total demand, and was in a flourishing condition during the War period. The 'silk' bangles imported from Japan are, however, a serious rival to the home-made article.

The factory industry is yet in a condition of infancy and its production is mainly confined to manufacture of lampware and, to a less extent, of bottles and carboys. As a result of the stimulus given during the War period by the demand for specialized glass passing through the Munitions Board, several factories have with some success turned out glass tubing, flasks, beakers, Petri dishes and test-tubes; and a few works have been started to meet the demands of scientific laboratories controlled by the Indian Medical Service. Indian factories cannot, however, turn out sheet and plate glass, laboratory or table glass or artistic glassware, though the Ogale Glassworks in the Aundh State (Bombay) have recently succeeded in producing flower-pots of different designs.

§30. **Imports of glass.**—In the pre-War days India imported glass and glassware valued at Rs. 190 lakhs, the principal imports

being bangles, beads, false pearls, sheet and plate glass, lampware, bottles and phials, soda-water bottles, tableware, etc. Austria and Germany held a predominant position in the trade, their share being 57 per cent of the aggregate imports. During the War, the imports of bangles and lampware decreased and their place was partially taken up by Indian wares. The total value of glassware produced in India was estimated at Rs. 40 lakhs for 1917-18. It was estimated by the Tariff Board in 1932 at 140 lakhs. Japan has increased her share in the imports of glass enormously. In 1929-30, imports were valued at Rs. 252 lakhs and mainly came from Japan, the United Kingdom, Germany, Belgium and Czechoslovakia, which shows that the Indian industry is still in a condition of infancy. The value of the imports receded to Rs. 165 lakhs in 1930-1, 122 lakhs in 1931-2 and again in 1933-4. In 1935-6 it increased to 139 lakhs, but declined to 128 lakhs in 1936-7. Japan still retained her predominant position in the trade, her relative share being 49 per cent.

In addition to foreign competition other difficulties are inexperienced control, lack of trained men, insufficient supply of essential materials like coal and soda ash, sand and lime, inadequate finance, etc. In 1932, according to the figures published by the Tariff Board, there were 59 glass factories, the chief centres being Bombay, Jubbulpore, Allahabad, Naini, Bijhoi, Ambala, Lahore and Calcutta. The glass industry has a wide geographical distribution in India and there are marked differences in the nature of its products and in the methods of their manufacture in its location. But all branches of the industry have a common need for the same raw materials.[1] The choice of sites for the glassworks, especially during the War period when the high prices led to the neglect of this factor, has not always been quite happy, and personal considerations rather than convenience in respect of the vicinity of raw materials and markets have often been allowed too much influence. Allahabad and Naini in the United Provinces enjoy enormous advantages over other centres like Bombay owing to their location in the vicinity of raw materials and fuel supplies.[2]

The fuel difficulty may be overcome by the supply of cheap electricity for working electric glass-furnaces, but this is not such an easy matter as used to be once fondly imagined. Labour difficulties are no doubt serious as the glass industry even in its simple form is highly technical and can be efficiently conducted only by scientifically trained managers and expert workmen. Useful

[1] See *Report of the Tariff Board* (Glass Industry), par. 4.

[2] See Fox, *Notes on Glass Manufacture* [Bulletins of Indian Industries and Labour, No. 29 (1922)].

work has been done by the Paisa Fund Glassworks at Talegaon in training glass-blowers, and the expansion of the industry under War conditions was chiefly due to the supply of men who came from this place, although the training given there leaves much to be desired. Sir Alfred Chatterton suggests the establishment of a Government glass-factory equipped with an efficient technological laboratory and a competent staff of experts and skilled glass-workers.[1] Railway facilities are also necessary.

§31. **Protection to the glass industry.**—In response to the representation of the glass manufacturers in India the Government of India referred the claim of the glass industry for protection to the Tariff Board in October 1931. The Board, which submitted its report in 1932, recommended the grant of protection for a period of ten years and outlined proposals for protective duties on sheet and plate glass, bangles, beads, false pearls, glass and glassware. The Government of India's decision, which was announced as late as June 1935, was adverse to the findings of the Tariff Board. They did not accept the plea for protection on the ground that the absence of indigenous supplies of raw materials (namely soda ash) constitutes a disadvantage to the industry which cannot possibly be balanced by any advantages which it possesses in other respects. They have, however, postponed their final decision until the possibilities of tapping new sources of supply of soda ash are fully explored. In the meantime they have decided to afford the glass-manufacturing industry a certain measure of relief by way of a rebate of duty on imported soda ash, the refund being full in the case of soda ash of British and Colonial origin and partial (in excess of 10 per cent) in the case of other soda ash. This concession will continue for three years, at the end of which period, if it appears that a prima facie case for protection then exists, further reference will be made to the Tariff Board. This decision of the Government of India has created great disappointment among the glass manufacturers and has been the subject of adverse criticism in general. The Tariff Board, while admitting that satisfactory sources of soda ash were not yet in existence in India, did not consider that this fact in itself invalidated the claim for protection advanced by the glass industry.[2]

§32. **The cement industry.**—It is surprising that in spite of the large home market in India, favourable conditions to manufacture and the national importance of the industry, the cement industry occupied an insignificant position before the War, and was not able

[1] *Industrial Handbook*, p. 269.

[2] *Report of the Tariff Board* (Glass Industry), par. 39.

to produce cement up to the requirements of the British standard specifications. Even before the War India consumed large quantities of cement, importing about 180,000 tons a year. The demand for cement has rapidly increased after the War and is now in the neighbourhood of 1,000,000 tons a year. The use of ferro-concrete in bridges and heavy structural work of all kinds is extending rapidly. It has even been said that the Steel Age is now giving place to the Cement and Ferro-concrete Age.

The manufacture of Portland cement commenced in Madras as long ago as 1904. It was, however, only on the eve of the War that production on a large scale was contemplated in India by the three companies formed in 1912-13. The earliest to start operations was the Indian Cement Company at Porbundar (Kathiawar) followed by the Katni Cement and Industrial Company (Central Provinces) and the Bundi Portland Cement Company (Rajputana). Recently the industry has developed especially under the patronage of the Government who purchased, during the latter part of the War, the great bulk of the output. In the post-War boom period, a number of companies were floated under the temptation of large profits which the industry was then earning. The three old companies doubled their output and seven new ones were projected and six of them started operations by 1923. Thus the development was very rapid and the aggregate production increased from 945 tons in 1914 to 236,746 tons in 1924, the imports showing a decrease from 165,733 tons to 124,186 tons during the same period. The imports further declined to 112,000 tons in 1930-1 of which 63,200 tons was supplied by the United Kingdom, other principal sources being Japan, Germany, Italy and Belgium. In 1936-7 imports of cement showed a further decline and amounted to 51,000 tons valued at Rs. 19 lakhs, the Madras Presidency and Burma having the largest share in the imports owing to the remoteness of their situation from Indian cement works. In the same year the total production of Portland cement in India amounted to 997,000 tons as compared with 643,000 tons in 1933-4 and 593,000 tons in 1932-3. The quality of Indian cement is not inferior to that of the British product and it more than holds its own against the cheaper continental cement. The Indian cement industry has recently (1936) taken a great step forward with the formation of a new effective combine known as the Associated Cement Companies of India, Ltd., thanks to the initiative taken by the late Sir F. E. Dinshaw. This striking merger of the ten principal concerns is expected to show considerable economies in working.[1]

[1] *Review of the Trade of India*, 1936-7, p. 82.

The Tariff Board found that the industry possessed natural advantages, such as abundant limestone of excellent quality occurring in many parts of the country close to railway lines; suitable clay also close to railway lines; and the production of gypsum in the country, though it has to be transported over long distances. But the industry labours under a considerable handicap with regard to fuel as most of the works are situated away from the coal-fields. Regarding markets, the Board points out that the up-country market is a naturally protected market for the Indian cement works, which, except for the Kathiawar factories, are above 300 miles from any port. Elsewhere, Indian cement has to face the competition of foreign supplies. However, as the principal market for cement in India is not up-country but in the ports of Bombay and Calcutta, most Indian factories are at a disadvantage here, being away from the ports.[1]

The Tariff Board, to whom the claim of the industry for protection was referred in April 1924, declined to recommend protection to the industry on the ground that it was suffering from over-production and prices were determined by internal competition among the Indian manufacturers and not by the imports. The Board calculated that the Indian works were already capable of supplying a maximum output of 600,000 tons, whereas the annual consumption was only 390,000 tons.[2] It considered, however, that it would not be long before conditions became stable, and with a view to the removal of the handicap to which Indian cement is subject owing to the great distance of most of the factories from the coal-fields or the ports, recommended that legislation should be introduced authorizing the Government to pay bounties on cement consigned from Indian factories to certain ports or to railway stations within a specified radius of these ports, provided the payment of bounties did not lead to a reduction in the price of Indian cement in relation to the price of imported cement. The Government of India did not accept the principle of such conditional legislation and decided not to take any action on the report.

§33. **Other inquiries by the Tariff Board.**—(i) *Coal industry.*- Reference has already been made to the competition of foreign coal, especially of the South African coal, and to the demand for

[1] *Report of the Tariff Board* (Cement Industry), pars. 8-12.

[2] Since the Tariff Board reported there has been a striking increase in the internal consumption as shown by the fact that in addition to the greatly increased home production of 997,000 tons in 1936-7, 51,000 tons of cement was imported, as stated above, during the same year.

protection for the Indian coal industry.[1] The Tariff Board concluded its inquiry in 1926 and reported that there was no case for general protection, but that a duty at the rate of Rs. 1-8-0 per ton would be justifiable. The Majority Report pointed out that a case had not been made out for a protective duty on all imported coal. No doubt the industry possesses great natural advantages but protection would not result in any substantial development. The depression in the industry was principally due to over-rapid development during a period of high prices. Moreover, in principle, measures which tend to raise the cost of fuel should not as a rule be adopted unless the reasons for them are cogent and convincing. The Tariff Board advised colliery-owners to try to remove the prejudice in the west of India regarding Bengal coal. The certificates issued by the Coal Grading Board should be a great help in this connexion.[2] Mr (now Sir) Padamji Ginwala in his separate Report pointed out that a protective duty on English coal was not justifiable as it is of a kind and quality different from and superior to Indian coal which cannot reasonably be expected to compete with the former. The imports from Australia and Japan were negligible. Hence there was no need for a protective duty on imported coal, except on South African coal.[3]

Mr Ginwala dissenting from his colleagues recommended that a countervailing duty of Rs. 1-8-0 per ton in addition to the existing duty of 8 annas per ton should be imposed on South African coal. He held that extensive damage had been done to the Indian coal industry by the competition of South African coal in India and the Eastern markets, and that the bounty, in the form of freight concessions to the export coal and part of the bunker coal, granted by the South African Railways, was the principal cause of the damage and that the imposition of a countervailing duty was justifiable in accordance with the policy of discriminating protection. The Government of India agreed with the unanimous finding of the Board that the case for a protective duty on all imported coal had not been established, and endorsed the view of the majority that in the existing circumstances the imposition of any duty was not advisable. The issue of a countervailing duty of Rs. 1-8-0 per ton on imports of South African coal (in addition to the existing revenue duty of 10 annas per ton on foreign coal) was once again raised by the Associated Chambers of Commerce who, at their annual conference in 1935, put in a strong plea for the levy of such

[1] See vol. I, ch. i, §29.

[2] *Majority Report of the Tariff Board* (Coal Industry), par. 52.

[3] *Minority Report of the Tariff Board* (Coal Industry), par. 2.

a duty with a view to giving protection to the Indian coal industry against imports of South African coal which take away the demand, which is already small in comparison with the output of coal.[1] (ii) *Match industry.*—With the exception of the Gujarat Islam Match Factory in Ahmedabad founded in 1895, there was no successful manufacture of matches on a commercial scale in India before 1921. From time to time factories on a small scale were started, but they soon closed down owing to unsuitable location, inadequate capital, or inefficient management. There has been considerable expansion in recent years as a result of the imposition, in 1922, of an import duty for revenue purposes on matches of Rs. 1-8-0 per gross, or more than 100 per cent *ad valorem.* The industry commands a large home market, consumption being estimated at seventeen million gross a year. Labour is cheap and well able to manipulate the simple machinery. There are at present about twenty-seven factories with a capacity of 500 gross a day or over. The most striking development has been the establishment, in view of the import duty, of match factories in India by the gigantic Swedish combine, which already controls about seventy per cent of the total world's demand, and there has been considerable agitation by the Indian Chambers of Commerce about the adverse repercussions of this dominant foreign concern on the indigenous industry. Regarding the claim for protection, the Board reporting in 1928 held that the prices of Indian matches were regulated by internal competition and the consumer got them as cheap as it was possible to get them and that the industry would be able to resist world competition without the assistance of the State. It recommended, however, that the current revenue import duty of Rs. 1-8-0 per gross should be converted into a protective duty for an indefinite period so as to give assurance to the industry that it would not be deprived suddenly of the protection it had enjoyed so far. It did not, however, recommend any measures for the time being to safeguard Indian interests against the Swedish Match Company in India. It held that the company had been doing useful work in the expansion of the industry in India, and that with protection for the Indian industry it would help powerfully in developing Indian sources of supply of the raw material and, in general, in enhancing the standard of quality and introducing modern methods. The Board, however, advised the Swedish Match Company to adapt itself to Indian nationalist and political sensitiveness by reconstructing itself with a rupee capital and admitting Indian directors, and acknowledged the necessity of keeping a watch on the company

[1] See vol. I, loc. cit.

to see that it did not employ its large resources to establish a monopoly in India.[1]

The Assembly passed the Match Industry Protection Bill in September 1928 as recommended by the Tariff Board, by which a duty of Rs. 1-8-0 was levied on a gross of boxes each containing 100 matches. A duty of 4½ annas was levied on every pound of undipped splints used for match-making, and of 6 annas per lb. on veneers used in box-making. A considerable section of public opinion in the country along with the Indian Chambers of Commerce was strongly opposed to the policy of the Tariff Board and the Government in allowing a foreign concern like the Swedish Match Company to avail itself of the advantage of protection without the statutory adoption of the usual precautions to safeguard Indian interests. The Government assured the Assembly, however, that they would certainly take special precautions to see that the Swedish combine did not prove a menace to the indigenous industry by developing into a monopolistic concern.[2] They also announced that they did not contemplate keeping the protective duty for long at its present height. The Indian match industry, sheltered by a high tariff, is thus able to meet India's domestic requirements and imports of foreign matches are now insignificant. Only 379,000 gross of boxes of matches valued at Rs. 4 lakhs was imported in 1930-1, as compared with 13⅔ million gross valued at Rs. 204 lakhs in 1921-2. The imports in 1936-7 further declined to 55,000 gross valued at Rs. 48,000.[3] (iii) *Gold thread industry.*—It is gratifying that the Gold Thread Industry (Protection) Act, which was passed in February 1931, gave effect to the recommendations of the Tariff Board regarding the grant of protection to the industry in India. It imposed for a period of ten years, a protective duty of 50 per cent *ad valorem* on silver thread and wire including so-called gold thread and wire, as well as silver leaf and lametta, metallic spangles and articles of a like nature. It also restored the duty on silver plate and on silver manufactures 'not otherwise specified' to the original level of 30 per cent *ad valorem.*

[1] The Board held that it was utterly impossible to build up a cottage match-making industry in India, in view of the competition of the mass production of factories. See *Report of the Tariff Board* (Match Industry), 1928, pars. 131-2.

[2] The Federation of Indian Chambers of Commerce at their annual session in 1931 urged the Government to take steps to secure the acceptance by the Swedish Match Company of the recommendations made by the Tariff Board in view of its unfair activities, such as rate war with the indigenous industry.

[3] The imposition of an excise duty on matches in 1934 and the consequent changes in the import duties are dealt with in ch. xi.

Cottage Industries

§34. **Causes of the persistence of small-scale production.**—Industrial advance at the present time is generally associated with the predominance of production on a large scale. It must be remembered, however, that it does not necessarily bring about the total extinction of small-scale industry. Even in modern factory production, there are of course limits beyond which it is not advantageous to increase the scale of production. The most effective scale of production is a matter which to some extent depends on the kind of motive power used. The increasing use of electricity instead of steam would, for example, tend to make the unit of production smaller than the average factory at present without involving any sacrifice of important external and internal economies. Again, in every progressive society there are a number of articles, such as artistic products and many luxury goods, which do not lend themselves to standardized production. Further, many of the improvements in the material equipment of civilization give rise to a number of small establishments to keep them going. An illustration that readily comes to mind is the multiplication of workshops for mechanical repairs which come in the wake of any considerable development of motor transport. Finally, new industries, so long as they are in an experimental stage, are first tried on a small scale and it is only when their success is demonstrated that they are organized on a large scale.[1] It thus comes about that even in the most advanced countries of the West, a number of small industries exist and flourish side by side with large-scale industries. For example, in France more than ninety-nine per cent of the industrial establishments employ less than 100 workmen each and of these the great majority employ less than fifty workers each. It is interesting to observe that, even in England, the home of large-scale industry, as many as 36,000 factories and workshops employed not more than five workers apiece in 1897, and even as late as in 1913, in the majority of trades the number of employees per establishment was below twenty.[2]

§35. **Industrialization and cottage industries in India.**—In India, particularly under the present conditions, industrial expansion in the near future is likely to be marked by the multiplication of small-scale enterprises all over the country. This is, however, a different thing from saying that India's progress in industrialization will leave all the industries of the old type intact and in undiminished vigour. Some old, lifeless industries will almost always lie

Radhakamal Mukerjee, *The Foundations of Indian Economics*, p. 360.
Economic Journal, December 1922, pp. 489-90.

about the cradles of new-born modern industries, and we must expect that intense industrialization will be injurious to some of the handicrafts which exist at present. In some cases, the disappearance of old handicrafts may be unavoidable and must be accepted as the price of industrial progress. Every effort, however, should be made to minimize the suffering and demoralization attendant upon the transition and to ease the passage of inevitable change by taking care that it is not too sudden and by assisting those adversely affected by it to find a suitable alternative employment and in other ways. A brief account has already been given of the manner in which the economic transition in India has affected the various indigenous industries,[1] and it has been pointed out that the artisans were left to their own resources and had to meet the new situation as best they could without any sort of guidance or help from the State. This was a mistake and care should be taken not to repeat it in future. (i) Some of the old industries like hand-spinning have already succumbed, and we do not believe that the country is likely to gain by attempts to resuscitate it by artificial means, though we have already admitted that as an ancillary occupation to agriculture it has some small possibilities. (ii) There are other cottage industries whose products are competing directly with machine-made goods and which may be described as being in a state of suspended animation. Those who cling to them do so because of their unwillingness to give up their hereditary occupation, or because they are deterred by the hard conditions of factory work as at present organized, or it may be that they are forced to remain in their traditional vocation by 'the patron and incubus' of the petty artisan in India—the merchant-financier, who is interested in keeping him there indefinitely, so that he may recover his money and continue to exploit him. Each of these cases suggests its own appropriate remedy. Sheer conservatism must be overcome by propaganda and education which should teach the artisan quickly to adapt himself to changed circumstances. The dread of factory work must be removed by improving the lot of the factory worker and making conditions of work in the cities less deterrent than they happen to be at present. Emancipation from indebtedness must be effected by co-operative credit and other methods already discussed. (iii) The third category is that of cottage industries which do not suffer from inherent and irremediable weakness like the first two classes just noticed and may be fit to survive even under modern conditions.

[1] See vol. I, ch. v, §§20, 21, 25; also see *Report on the Survey of Cottage Industries in Madras Presidency* (1929).

Those industries, for example, which are closely connected with agriculture and which require simple tools have generally nothing to fear from factory goods. There are also cases where the artisans have successfully adapted themselves to the new conditions and learnt to use superior raw materials and better tools. 'The weaver has taken to mill yarn, the dyer to synthetic dyes, the brass and coppersmith to sheet metal, the blacksmith to iron rolled in convenient sections, in each case with advantage to himself from the lessened cost of production, which has greatly extended his market. In some districts in lower Bengal, the weavers use the fly-shuttle slay extensively; and they have recently adopted it in large numbers in the coast districts of the Madras Presidency; while it is also gradually coming into use elsewhere. The tailors invariably employ sewing machines, and town artisans readily take to improved tools of European or American manufacture.'[1] Again, the economic strength of some of the handicraftsmen is due to the fact that the goods they turn out are of such a character that they allow no scope for the employment of automatic machinery and large-scale production, or are not any cheaper or better for being machine-made rather than hand-made. Also, popular taste may require too great a variety for the goods to be profitably turned out on a large scale by means of modern mechanical appliances. Proximity of the market, and a more intimate knowledge of the consumers' wants may further turn the scale in favour of the cottage worker.[2] Further, the self-sufficiency of the village, though no longer preserved in its entirety, is not altogether a thing of the past even now, particularly where the railway has not yet penetrated, and consequently some of the artisans still continue to occupy their old recognized place in the corporate organization of the village and serve the simpler needs of the village-folk as in the days of yore, receiving their remuneration in the manner already described.[3] However, the self-sufficiency of the village is being invaded more and more, and as it disappears the position of these artisans will need to be adjusted.

[1] *Industrial Commission Report*, par. 255.

[2] 'Thus some kinds of head-wear, *dhotis* and *saris* made by the hand-loom weavers have not been displaced by modern factories. The weavers of Dacca, Murshidabad, Madura and Benares, those engaged in making embroideries in Lucknow and Delhi and lace in Surat supply commodities for which the demand in the country has not been seriously affected by competition with similar machine-made articles. The metal worker, the shoemaker, the goldsmith, the tailor, the confectioner and other craftsmen fall into the same category and are similarly protected.'—*India in 1926-7*, p. 330.

[3] See vol. I, ch. v, §14.

Modern industry has made only a moderate advance in this country so far. Nor has the policy of free imports of cheap foreign manufactures, which was in full swing until quite recently, wrought anything like the complete destruction of all the indigenous industries. Workers in the various cottage industries still form a large percentage of the population in almost every town and village. Their numbers are still vastly larger than those of the operatives employed in organized industries.[1] And while striving for rapid industrial expansion we must watch it with reference to its effects on the welfare of these numerous humble artisans throughout the country.

We may repeat that this does not imply that the State should try to perpetuate the existence of all old industries whatsoever at any cost, but it does suggest a thorough investigation of the position of each cottage industry in view of the prospect in the near future of substantial progress towards industrialization. Where it appears that an old industry is doomed to extinction, it is the part of wisdom to accept the inevitable; and the problem in this case would be that of securing a painless euthanasia. Where, however, an industry of the old type possesses elements of inherent vitality, its survival should be assisted by every possible means. If large-scale organization is the essential condition of industrial progress we must accept it unhesitatingly while guarding against its peculiar evils and dangers. But it is obvious that where organization of the old type does not spell economic stagnation or weakness its continued prosperity should be the object of our solicitude. The cottage industry secures a happier existence for the craftsman who works under comparatively healthy conditions in his own home in the midst of his family. Understanding as he does the whole series of connexions between the making and the using of the articles he produces, he can take much greater interest in his work and is able to enjoy something of the pleasure of artistic creation. It is also clear that in the cottage industry with its autonomous worker, there is no place for any antagonism between the employers and the employed, the possibility of which constitutes an ever-present difficulty of modern industry.

In the light of these remarks we shall now proceed to examine briefly the present position of some of the cottage industries in India, and for this purpose we shall select the textile industries which are by far the most important and the widest in extent in India.

[1] See *Industrial Commission Report*, par. 255.

§36. **The cotton hand-loom industry.**—Hand-spinning of cotton is now almost completely extinguished and it need not detain us.[1] The extent and importance of the hand-loom industry are not generally appreciated. The Cotton Textile Tariff Board in its Report published in 1932 estimated the number of hand-looms at 1,984,950 while the census of 1931 returned 2,575,000 workers as being engaged in cotton and silk weaving and spinning.[2] And though it is no longer true that 'everyone from the Cape of Good Hope to China, man and woman, is clothed from head to foot in the product of Indian looms' (Pyrard), and though the present position of the industry is far from satisfactory, it has a great future before it if suitable measures are taken to organize it properly.

There is no gainsaying the fact that hand-loom weaving has suffered—and in some cases suffered severely—on account of the competition of mill-made goods and the weaver has had no chance of success when pitted against large-scale organization turning out exactly identical articles at a much smaller cost. In these circumstances, the weaver has had to abandon his calling in favour of agriculture, often joining the ranks of landless labourers, and is forced to lead a very precarious existence with even less power of resistance against famine and scarcity than the ordinary cultivator. His position is, however, stronger in the case of goods which are either too coarse or too refined and artistic and as regards which the hand-loom can hold its own against machinery. The poorer classes, especially the villagers, prefer the hand-loom cloth as it is supposed to be stronger and more durable than anything of the same kind produced by the mills. The mills cannot take up the manufacture of the large number of specialized types of cloth, the use of which is decreed by the slow-moving Indian custom, because although the demand in the aggregate is large, the demand for each type is too small to make its manufacture in a factory economically worth considering. There is, of course, also the case of the finest fabrics of genuine artistic excellence where individual skill is required. There is thus a clearly demarcated field where the handicraftsman remains supreme and which cannot be usurped by the factory. The table on page 30 shows an increase in the Indian hand-loom production between 1905-6 and 1936-7 from 108

[1] We have already discussed the possibility of the revival of the charka in vol. I, ch. viii, §19.

[2] For an excellent summary of the present position of the cotton hand-loom industry in the various provinces see *Report of the Central Banking Inquiry Committee*, par. 299. See also *State Action in Respect of Industries, 1928-35*, ch. iii.

crore yards to 149 crore yards. This means that the hand-loom supplies nearly 25 per cent of the total demand for cloth in India. The inability of the Indian mills to make up adequately the deficiency of imported cloth during the War and the very high prices of mill-woven cloth after the Armistice were factors which substantially helped the weaver. Since 1922 however, the weaver has suffered by foreign (especially Japanese) competition and increased competition of Indian mills; though the more skilful and enterprising men have taken to silk-weaving and lace work. Altogether the hand-loom weaving industry has displayed a surprising degree of vitality and adaptability.

The weaver working in his own home works longer hours than the factory labourer, and has also the advantage of unpaid assistance from the women in the family in the intervals of domestic work. He is moreover content with a very small margin of profits as his standard of comfort is low. While this is a factor which increases his competitive power, its existence is not a matter for congratulation. The aim of reform ought to be so to improve the efficiency of the hand-worker as to enable him to adopt and maintain a higher standard of life. Although there are sound economic reasons for hoping that he ought to prosper if he confines himself to his proper sphere of work where the factory cannot trench on his dominion, his actual position is one of extreme poverty and distress. The discussion of the causes of and remedies for this state of things is capable of a generalized treatment applicable to all the cottage industries and has been placed at the end of the chapter together with the recent measures of help to the hand-loom industry adopted by the Government of India.

§37. **Woollen industry.**—The manufacture of woollen goods in some shape or form is found in all parts of the country for the simple reason that the sheep is a ubiquitous animal, though the quality of the wool varies from place to place, the sheep in the hilly tracts generally yielding wool of finer quality than those in the plains.

Under the Moguls the manufacture of woollen carpets had reached a high pitch of excellence. The demand for woollen carpets came mainly from the royal courts and the nobility, and the industry found its natural habitat in the principal capital cities, though it migrated to other centres on the break-up of the Mogul Empire. The downfall of the Empire practically extinguished the local demand for carpets, but it was gradually replaced by foreign demand after the establishment of British rule. The foreign demand, however, although it helped to stay the economic ruin of the artisans, was responsible for a deterioration in the quality

of the goods. It encouraged the production of cheap articles fashioned according to patterns sent out to India from abroad. The growing use of aniline dyes was a further cause of deterioration. The opening of the foreign markets also led to the appearance of a large number of middlemen, which is the characteristic feature of trade in modern India, especially of the export trade; carpet-weaving in India at the present time depends almost entirely on foreign demand which absorbs as much as 90 per cent of the total production.

The carpet-weavers were mostly Mohammedans who organized themselves into caste guilds which controlled the wages of workers and the prices as well as the quality of the goods produced. The guilds seemed to have functioned effectively and exercised a salutary influence on the industry. In course of time, however, the guild organization suffered disintegration. Also, the craft ceased to be the monopoly of Mohammedans and has come to be practised by a small number of Hindus as well, who often combine it with agriculture. About fifty years ago, carpet-weaving was introduced into the jails, and the convicts trained in them often found employment in factories started at different places by exporting firms.

Considered as a cottage industry, carpet-weaving is in a languishing condition on account of the ignorance and poverty of the weaver and the absence of organization. It is usual for the weaver to accept advances of money from the dealer, and the system of advances tends to convert the independent handicraftsman into a bond slave of the dealer and destroys personal interest in the work on the part of the weaver and all incentive for improvement. He is not able to take his labour or goods to the best possible market but must work according to the dictation of the dealer.

The manufacture of shawls had attained great renown in India in the pre-British days, especially in Kashmir, and the Moguls were particularly interested in its development. For example, it was due to the efforts and patronage of Akbar that the industry came to be established at other centres than Kashmir, such as Amritsar, Lahore, Ludhiana, etc. The shawls of Kashmir were unrivalled for softness and fineness of texture and were in great demand in the countries across the frontier and in Russia. The famine of 1830 dealt a severe blow to the industry from which it never quite recovered and its difficulties were enhanced by the numerous imposts to which it was subjected in the Kashmir State. The development of an export trade to Europe which began in the early years of the nineteenth century was helpful in arresting the decline of the industry and is supposed to have at one time provided

employment for over 15,000 workers. The Franco-German war of 1871, however, was responsible for an abrupt shrinkage of the European demand. Nor was this sudden check temporary in character, for shawls rapidly went out of fashion in Europe and in spite of the close of the war no revival was experienced by the trade. Another important factor which contributed to this result was the starting of shawl manufacture at Paisley in England. The sale of the famous Paisley shawls at one time exceeded a million pounds sterling and they successfully ousted the Indian article from the European markets.

Another woollen manufacture that is widely prevalent in the country is that of the coarse rough blanket (*kambli*), which is put to such a variety of uses by the humble folk in the villages and 'serves as bed, portmanteau, overcoat or umbrella'. The production of blankets is generally a by-occupation pursued by shepherds or agriculturists who are mostly Hindus. There is no export trade in these articles but the industry is nevertheless important because a very large number of people are engaged in it. It is immune from the competition of machine-made goods because the latter cannot stand the rough wear to which the *kambli* is subjected. Having regard to the facility with which the raw materials can be obtained in every part of the country and the largeness of the home market, blanket-weaving would appear to hold out great promise as a cottage industry and its possibilities should be systematically explored. The woollen hand-loom industry gives part-time employment to about 400,000 people.

§38. **Sericulture and silk manufactures.**—The first essential for the production of raw silk is an adequate stock of mulberry trees for feeding the worms in their larval stage. The soil in which the mulberry grows, and the age and condition of the trees are important factors governing the successful practice of sericulture. An abundant and cheap labour supply is another indispensable factor. Whatever success sericulture has achieved in India has been confined to those parts of the country, like Bengal, Kashmir and Mysore, where all these conditions are found to be present.

Roughly, during the first three-quarters of the seventeenth century the East India Company was primarily interested in the trade in raw silk. Subsequently the Company realized that greater profits were to be made by exporting Indian silk manufactures to England and they pursued this policy with sufficient vigour and success to alarm weavers in England. Owing to the opposition of English weavers and for other reasons, the East India Company once more reverted to the trade in raw silk and suffered heavy losses, which compelled them to withdraw from active participation

in the trade after 1835. In the meanwhile, the policy of favouring the production of raw silk and discouraging that of manufactures had an adverse influence on the indigenous weaving industry.[1] Its position was further worsened by causes similar to those referred to in explanation of the decline of the woollen manufactures of carpets and shawls, namely a change in the nature of the European demand and the progress of silk-weaving in Europe, which soon outstripped the Indian industry as regards technique.[2] To this list of causes must be added the emergence of Japan, China and the United States as competitors in the European markets, and as regards the local market, the demand for the kind of goods produced on the hand-loom was diminishing among the educated and well-to-do classes who might have been expected to fill, but did not fill, the void created by the extinction of the old nobility and the royal courts.

In short, both sericulture and silk-weaving have suffered in India in recent times. India's exports of the raw material have not only decreased in volume but have changed in form. Most of the silk exported at present is in the form of waste or cocoons. The reeling is so badly done in India that foreign countries prefer to take the cocoons from this country and do the reeling themselves. The same reason explains the increasing popularity of imported silk in India. The Indian weavers themselves prefer the more even re-reeled Chinese or Japanese to the home-made product which is ' full of knots and loose ends and of unequal strength '. Efforts are being made, especially in Bengal, to improve the quality of the Indian silk. The Agricultural Department in that province runs two sericultural schools. A large number of seed farms have also been started and are managed under departmental supervision by students who have completed their course at one of the schools. The students trained at the schools are given awards of Rs. 250 each and are provided with ' seed stocks ' from the Government nurseries for erecting rearing-houses. This is known as the Selected Rearers System and is showing good results. Attempts are also being made in Assam and the Indian States of Kashmir and Mysore to encourage sericulture. In 1935 the Government of India established the Imperial Sericultural Committee, and grants

[1] The decline of the silk industry is indicated in a striking manner by figures for the export trade. The value of the export of silk manufactures in 1886 was Rs. 32,96,000 ; in 1936-7 it amounted to only Rs. 2,83,000.

[2] ' Up to 1830 India exported more woven silk than she imported, but since about 1840, her silk goods have been gradually ousted from both the internal and external markets, and the export of silk manufactures has tended to decline slightly since the pre-War period.'—Anstey, *The Economic Development of India*, p. 284.

amounting to Rs. 93,000 as recommended by it were allotted to various provinces to enable them to set up schemes for the benefit of sericulture in Bengal, Assam, Madras, Bihar and Orissa and Burma.[1] The schemes are designed to increase production of disease-free seeds and to help in investigating questions connected with silk-worm disease. An annual grant of Rs. 1,00,000 for five years from 1 April 1935 to 31 March 1940 was promised by the Government of India. The additional stimulus to silk production provided by the high revenue duty of 15 per cent on imports of foreign silk was partially lost owing to the reduction of the duty on imported artificial silk to 7½ per cent in 1927, though owing to tariff changes in 1931 the duty was again restored to its former level of 15 per cent. Imports of artificial silk yarn have been rapidly increasing in recent years. The increase between 1922-3 and 1928-9 was from 225,000 lb. to 7,700,000 lb. The imports in 1936-7 reached the record level of 17,600,000 lb. valued at Rs. 99 akhs. In the same year the total imports of artificial silk amounted o Rs. 3,86 lakhs. Japan dominates all branches of the import trade. Reduced prices and improved quality have contributed to the increasing popularity of rayon products. The chief sources of import of yarn are Japan and Italy. As to silk-weaving, the indigenous industry has been steadily losing ground to manufactures from abroad for want of efficient organization, the hopelessly inadequate resources of the average weaver and his antiquated methods of production. The manufacture of silk goods as a cottage industry enjoys certain exceptional advantages in the existing circumstances in India. Large-scale production with modern mechanical appliances is relatively more difficult than in the case of cotton manufactures and has hardly yet made a beginning in this country. Besides, silk manufactures, being largely of the nature of luxury goods in India, admit of a great diversity in workmanship, so that a large sphere of operations will always remain which the hand-loom alone can occupy. As regards imports of finished goods from abroad, the home industry is sheltered in a large measure by the import duty on manufactured goods which is twice as high as in the case of the raw material. Lastly, there has been in recent years the growth of a well-marked tendency on the part of Indians to extend a patriotic preference to indigenous as against foreign goods. Circumstances would thus seem to be peculiarly propitious at present for reviving the silk cottage industry.

It may be mentioned in this connexion that the Indian Tariff (Textile Protection) Act, 1934, also gave effect to the decisions of

[1] See *India in 1934-5*, p. 25.

the Government of India on the recommendations of the Tariff Board appointed to investigate the claims of the sericultural industry to protection. It imposed protective duties on raw silk, silk yarn, piece-goods and mixtures as well as on fabrics of artificial silk and mixtures; in addition the duty on artificial silk yarn, which competes with silk yarn, was raised to 25 per cent *ad valorem* with an alternative minimum specific duty of 3 annas per lb.

§39. **Other cottage industries.**—The present position of different cottage industries has already been indicated in the chapter 'Economic Transition in India', (vol. I, ch. v), while the cottage branch of the oil-milling, tanning, glass-making and match-making industries has been noticed in our treatment of these industries. The present position and prospects of subsidiary agricultural industries have also been discussed under Agricultural Organization (vol. I, ch. viii). There are numerous other cottage industries such as embroidery work, furniture, metal and cutlery, gold and silver thread industries, pottery, soap-making, cap-making, doll- and statuette-making, bead manufacture, etc.[1] For want of space we cannot enter upon an exhaustive treatment of all cottage industries here.[2] Suffice it to say that, having regard to the important place they will always occupy in our national economy, we can no more afford to neglect them than we can afford to neglect agriculture, however keen our concern for the rapid progress of modern industrialism.

§40. **Methods of aid to cottage industries.**[3]—The ignorance and poverty of the small artisan together with the absence of any effective organization for directing him make it necessary that a comprehensive scheme for assisting him must be elaborated and put into operation. The first obvious step, of course, is better general education which should make some attempt to provide manual training and instruction in industrial crafts. Over and above this, sufficient provision for the education of the artisan in special industrial schools, preferably controlled by the Director of Industries, is necessary. In Bombay, the Department maintains six weaving schools for the benefit of the hand-loom weavers. The Industrial Commission also recommended that, for the training of the more intelligent of the artisans, demonstration hand-loom factories assisted by the Government should be started, and a

[1] For an interesting description of the various cottage industries in Madras, see *Report on the Survey of Cottage Industries in Madras Presidency*; also Gadgil, op. cit., pp. 299-304.

[2] For details of wages, etc. of some of these see Matheson, op. cit., ch. vi and Appendix IV.

[3] See A. G. Clow, *The State and Industry*, ch. vi and *Report of the Central Banking Inquiry Committee*, par. 300.

commercial section should be attached to the weaving schools, so that the more enterprising artisans so trained might be fitted to start small hand-loom factories on their own account. The jails and reformatory schools make a speciality of teaching various industrial crafts to their inmates such as carpentry, cane and bamboo work, etc. with a view to enable the prisoners to set up as craftsmen after they are discharged. Their career, however, after they are released is not systematically watched over a sufficiently long period and it is difficult to say how far this effort at giving instruction in handicrafts to the prisoners is helping the maintenance of cottage industries. One of the handicaps from which the cottage industries very often suffer is the difficulty of obtaining cheap raw material of good quality. The necessity of improving the quality of indigenous cotton and silk, for example, is obvious from this point of view. Another needful reform is the invention and introduction of more efficient tools and implements. Bihar and Orissa have been divided into ten circles, each in charge of a demonstrator who conducts peripatetic demonstrations of improved appliances. These demonstrations are based on the Cottage Industries Institute which carries out experiments in its various sections, arranges for the supply of looms, dyes, accessories, etc. and introduces new cloths and new patterns among weavers. Similar services for the silk industry are performed by the Bhagalpur Silk Institute, while the experimental blanket factory at Gaya is attempting to do the same for the primitive blanket industry in the south of the Patna Division. In the Central Provinces, the Department of Industries is carrying on a campaign to introduce improved slays among weavers. Valuable assistance can also be granted by providing technical advice and facilities for technical training and by giving the artisans new patterns and designs to work upon so as to increase the sales. In many cases a better organization of production may be possible. There may, for example, be greater scope for division of labour even in simple cottage industries. Bringing the workers together under one roof would give us the factory system in its essentials, though the factory may not be situated in a congested urban area and may not use mechanical power. This form of organization has been found to be unsuccessful because the independent cottage worker cannot be easily broken in to factory discipline. Another possible variant is afforded when the workers work in their own homes under the direction of factory managers who undertake the responsibility of financing production and marketing the goods. This system, however, lends itself to exploitation and sweating in a worse form than is possible in a regular factory.

By way of providing the handicraftsman with the requisite capital, the Industrial Commission suggest that in some cases small loans should be given by the Director of Industries, or that tools and plants should be supplied on the hire-purchase system so that they become eventually the property of the artisans. But the most promising solution of the problem is afforded by co-operative credit. The principle of co-operation is of very fruitful application[1] for the purpose of bettering the lot of the small artisan, whether by providing loans at a moderate rate of interest or helping him in the purchase of raw materials, tools and implements and in the sale of the finished article. If any industrial banks are started, it may be possible for them to finance, not only large-scale industry, but also small-scale enterprises with whom close touch could be maintained through numerous branches.[2] Another weakness of the present system is the absence of an effective marketing organization. The artisan fails to get the best price for his goods, being unable to advertise his wares properly. The Arts and Crafts Emporium at Lucknow and a similar one at Lahore are intended to remove this handicap to some extent but many more such emporiums are required to produce any appreciable effect in the desired direction. Much attention is paid in foreign countries to marketing. The toy industry of Germany and the cottage industries of Japan owe their success to the existence of the essential business organization which takes over the produce of the industries and disposes of it within the country as well as abroad. At present the foreign markets are neglected in India and even the home market is not properly nursed. The Swadeshi Stores in Bombay form a good example of an active and successful agency for internal distribution of indigenous products and furnish a type worthy of imitation. The Department of Industries should work in co-operation with a business institution of this sort in order to take the products of Indian handicrafts to customers all over the country and outside. Apart from the creation of such an organization and the establishment of co-operative societies, a central trading organization is necessary, not only to find the widest possible market for the cottage wares, but generally to secure co-ordination and co-operation between the isolated and unrelated cottage industries. The Central Banking Inquiry Committee have endorsed the recommendation made by the Provincial Banking Inquiry Committees in favour of the establishment of licensed warehouses and co-operative wholesale depots for storing and sale of the products of cottage industries. The Committee

[1] See vol. I, ch. x, §11.

[2] See *Report of the Bombay Provincial Banking Inquiry Committee*, par. 177.

hope that with the help of these and under the guidance of the Provincial Marketing Boards proposed by them, most of the marketing difficulties will be reduced, if not altogether removed.[1]

The question of the marketing of the hand-loom products was considered at the sixth Industries Conference (1934) and promising schemes which are based on co-operative effort have since been adopted by the Provincial Governments of Madras, Bombay, Bengal, the Central Provinces and Berar, the Punjab, Bihar, Orissa and Burma. In Bombay, five Co-operative Industrial District Associations have been formed at important centres. Each Association is to have a shop of its own which will accept on consignment account against partial advances, and sell, on a commission basis, products of hand-loom weavers. A marketing officer has also been appointed.[2]

One often hears complaints about the deterioration of artistic taste among the people of this country including the educated classes. A wide advertisement of artistic indigenous products will not only benefit the handicrafts, but it will also assist the formation of a proper æsthetic taste among the people.

Another way in which the Government might help is by extending their patronage to the cottage industries. The Provincial Stores Purchase Department in the United Provinces, for instance, has apparently accepted this policy and buys goods whenever possible from local manufacturers.

Reference has already been made to another welcome sign of increasing State interest in the regeneration of cottage industries, namely the State Aid to Industries Acts passed by the various provinces. We are in full agreement with the recommendation of the Central Banking Inquiry Committee that Provincial Governments should devote their earnest attention to the development of rural and cottage industries in view of the fact that some of these industries provide subsidiary occupations for the large mass of the agricultural population, while some others are likely to provide alternative occupation for people now engaged in agriculture.[3]

§41. **Recent measures of State help to cottage industries.**—The Government of India have in recent years keenly interested themselves in the promotion of cottage industries in India, especially the cotton hand-loom industry and the sericultural industry. The sixth Inter-Provincial Industries Conference held in July 1934

[1] See *Report of the Central Banking Inquiry Committee*, par. 309.

[2] For further particulars regarding the various marketing schemes see *State Action in Respect of Industries, 1928-35*, pp. 26-29, and the *Annual Report on Co-operative Societies* (Bombay), 1935-6, par. 81.

[3] See *Report of the Central Banking Inquiry Committee*, par. 301.

discussed schemes submitted by the various Provincial Governments for the development of the hand-loom industry, the premier cottage industry of the country. The Government of India announced at the conference that they had decided to spend about Rs. 5 lakhs every year for five years for the development of the hand-loom industry.[1] The schemes in the several provinces thus financed are of a varied character. They include the training of weavers in improved methods of production, the establishment of sale depots and weavers' co-operative societies for marketing of hand-loom products, and the introduction of new patterns, new designs and improved appliances. The grants to the provinces are allocated on the basis of provincial expenditure and the consumption of yarn. The seventh Industries Conference also decided in favour of holding exhibitions of hand-loom machinery and fabrics.[2] We have already reviewed the measures adopted by the Government of India to encourage and protect the sericultural industry. Early in 1936, the Government of India, when declining to accept the Tariff Board's recommendation of the woollen industry for protection, announced their intention of asking the Assembly to sanction a grant of Rs. 5,00,000, to be spread over five years, for the benefit of the cottage industry.

The interest now being taken in the revival of cottage industries in the country by the several Provincial Governments since the advent of Congress Ministries in 1937 is calculated to accelerate the pace of progress in this direction.[3]

[1] *State Action in Respect of Industries, 1928-35*, p. 20.

[2] Proceedings of the seventh session of the Industries Conference held at Delhi, October 1935.

[3] For particulars regarding the measures adopted by the All-India Village Industries Association, established in 1935 under the auspices of the Indian National Congress to encourage the revival of cottage industries in the villages, see the Annual Reports of the Association.

CHAPTER III

INDUSTRIAL LABOUR

§1. **Growing urgency of labour problems in India.**—With the steady progress of large-scale industry and the rise of factory towns modern labour problems as understood in the West are gradually coming into prominence in India. Owing to the slowness of the process of industrialization in this country our labour problems today are not so formidable as in the West. But the time is not far distant when they will assume similar dimensions. The War has led to a new mass awakening, and workmen are becoming more and more conscious of their importance and rights. The War-time and post-War rise in prices which greatly increased the cost of living led to labour unrest, and forced labour to organize itself so as to safeguard its interests. The Indian labour movement has now been definitely linked up with the international labour movement, and India's labour representatives attend the International Labour Conference held annually. India has been already recognized as one of the first eight countries of industrial importance by the League of Nations. Lastly, the national importance of ensuring an adequate supply of an efficient and contented labour force in industries is being understood more and more by the Government and the people. This was attested by the appointment in May 1929 of a Royal Commission on Labour presided over by the late Rt. Hon. J. H. Whitley. The recommendations of the Whitley commission have been accepted as the foundation for the Government's labour policy and have powerfully influenced recent labour legislation.[1] Another factor which bids fair to exercise a decisive influence on the labour policy of the Government is the advent of Congress Ministries in a number of provinces in the middle of 1937. We may in this connexion invite attention to the press note which the Government of Bombay issued in August 1937 explaining their policy in respect of the industrial worker. 'The aim of the Government is to try and adjust the social and economic mechanism in such a way as to assure to the worker the satisfaction of at least his minimum human needs, security of service, provision

[1] The Whitley Commission's Report which was published in June 1931 is referred to throughout this chapter as *L.C.R.* The figures refer to pages of the Report. Thus: *L.C.R.*, 4 = *Labour Commission Report*, p. 4.

of alternative occupations in periods of unemployment and maintenance during periods of incapacity for work.'[1] The Bombay programme has been accepted as the basis of an All-India labour policy.

§2. **Growth of factory labour.**—During the period 1879-80, 47,855 persons were found in the cotton mills of the country, while the jute mills accounted for 59,222 workmen in 1889.[2] Between 1892 and 1929, the number of factories subject to the Indian Factories Act rose from 650 to 8,129 and the average daily number of operatives employed in them increased from less than 334,000 to 1,553,169 during the same period. According to the Labour Commission the number of perennial[3] factory workers was approximately 1,250,000. The memorandum submitted by the India Office to the League of Nations in 1922 gives the following striking figures regarding the total strength of India's labour supply:

Agricultural workers (excluding 77,664,886 peasant proprietors) who come within the scope of the work of the International Labour Office	27,810,130
Maritime workers, lascars, etc.	141,000
Workers in industries, including cottage industries, mines and transport	20,219,000

As shown by the 1931 census, the number of agricultural labourers increased to nearly 31,500,000. The number of earners plus working dependants in Industry, Trade, Transport and Mines amounted to 26,000,000. According to the All-India Report for Factories for 1935, the total number of factories in India was 8,831 and the average daily number of persons employed 1,610,921. In the same year the number of persons employed in mines in India was 253,970. If the test of the total number of workers alone is applied India is easily the first country in the world. With 10,000,000 occupied males more than in the whole of Europe she completely overshadows Italy (11,275,000), Japan (18,800,000), Belgium (2,600,000) and Switzerland (1,777,000).

§3. **Supply of industrial labour and its migratory character.**—The factory labourers in India do not constitute a wage-earning class exactly corresponding to the factory labourers in the Western countries. In these countries the labourers form a permanent class of industrial workers completely divorced from the land. Most of

[1] *Labour Gazette*, Bombay, August 1937, pp. 891 and 922-4.

[2] See R. K. Das, *Factory Labour in India*, pp. 15-16.

[3] By the term 'perennial factories' the following kinds of establishments are excluded: (i) those dealing mainly with agricultural products in the raw state; (ii) those which work only part of the year; and (iii) those which either use no mechanical power or, using power, employ less than twenty persons.

them have been brought up in the towns and some have abandoned the country permanently for the towns. The superior aptitude of the industrial worker in the West is to no small extent due to his early upbringing in a factory area. The Indian factory operative on the other hand is generally a migrant and he rarely severs his connexion with his village. It is not true that the typical Indian factory worker is essentially an agriculturist who has only temporarily forsaken his agricultural work in order to add to his income by a brief spell of industrial work in the city. The conception of the short-term recruit from agriculture is kept alive by the fact that a number of new recruits revert quickly to the village and the fact that the average worker does not remain in one factory for any length of time. The great majority of Indian workers in industrial centres are, however, at heart villagers with a village upbringing and village traditions and most of them intend to get back—and succeed in getting back—to their villages. Agriculture supplies the bulk of the recently established industrial population though some of it is drawn from the different village crafts also. The proportion of factory workers deriving some pecuniary benefit from agriculture is not so large as commonly supposed. Many of them have only an indirect interest in agriculture. For example, they may be members of a joint family having an agricultural holding or may have close relations actively engaged in agriculture. Most industrial workers are born in the villages where they spend their childhood—a tendency strengthened by the raising of the maximum age for industrial employment. Many workers leave their families behind them in their village and even when the wife accompanies the husband to the city she is generally sent back to the village for confinement. The numbers of workers supplied from the rural areas are increasing with the steady expansion of Indian industry. The labourer visits his village as often as financial circumstances permit. When he returns to the village, however, it is not necessarily in order that he may assist in the agricultural operations. He may prefer to remain unoccupied and enjoy a holiday as long as he can. Whilst in the city he maintains contact with the village in so far as he has to send remittances to his family or relations or his sahukar (*L.C.R.*, 11-14).

The causes of the migration of labour from the villages to the towns may be briefly examined. The growing class of landless rural labourers are the first to feel the pinch of agricultural distress, and improved means of communication enable them to leave the villages in search of work and higher wages in the factories, workshops, dockyards, mines, plantations and the great public works like railways and irrigation. In some provinces, for example the

United Provinces, Bihar, Orissa, and certain districts like Ratnagiri in the Bombay Presidency, the density of the population and the pressure on land are so great and the evil of uneconomic holdings has assumed such serious proportions that the petty landholders are under the necessity of migrating every year to the towns in order to eke out a livelihood. The joint family system also facilitates such migration as some members of the family can leave the village without having to break up their home or give up their land, as these can be left in the charge of other members who remain behind. Sometimes the agriculturist may seek employment in the towns to evade the village money-lender or to earn enough for buying cattle or more land. Sometimes again the village menials and drudges belonging to the depressed classes migrate to towns in the hope of bettering their prospects. But whatever may be the causes which drive the villager into the city the important fact to remember is his retention of the village connexion. According to the Labour Commission the chief cause of this is that ' the driving force in migration comes almost entirely from one end of the channel, that is, the village end. The industrial worker is not prompted by the lure of city life or by any great ambition. The city, as such, has no attraction for him and, when he leaves the village, he has seldom an ambition beyond that of securing the necessities of life. Few industrial workers would remain in industry if they could secure sufficient food and clothing in the village; they are pushed, not pulled, to the city ' (*L.C.R.*, 4).

§4. **Effects of migration.**—As a result of migration many sections of factory workers find themselves in an entirely unfamiliar environment of customs and traditions and even the language may be different. The force of old customs and sanctions is weakened. ' The ties which give village life its corporate and organic character are loosened, new ties are not easily formed, and life tends to become more individual. ' The health of the worker may be subjected to a severe strain owing to radical difference of climate, a defective dietary, excessive congestion and lack of sanitation, the temptations of enforced separation from his family. The worker is further demoralized by certain evils, comparatively unknown in the villages, such as drunkenness and gambling. As regards conditions of work, the worker finds himself subjected to unaccustomed strain of body and mind owing to disciplined hours of continuous toil instead of the spasmodic work with long intervals of rest to which he has been used. These hardships are more than many new recruits can bear and compel them to return to their villages. As the labourer desires ultimately to return to his village home, he

is unable to develop a permanent interest in his employment in the city and this is probably one of the reasons which prevents him from acquiring a high standard of technical efficiency. His frequent absence from work owing to his repeated visits to his village or to other causes makes it difficult to establish contact between employers and employees and militates against any form of effective organization among the workers themselves. The worker who returns after a period of absence has no guarantee of re-employment after his return and difficulties of reinstatement often place him at the mercy of the money-lender, the jobber or the labour supplier, the foreman and the liquor-seller.[1]

The contact with the village, however, is not without its advantages. In so far as the industrial workers have been brought up in healthier surroundings they bring with them a better foundation of physical health than could be built up in the cities. The periodical migrations to the village are also a great help in recuperating mental and physical energy. The home in the village is a convenient shelter to the labourer and his family in case of unemployment, sickness, etc. The village provides some kind of insurance against unemployment in the towns just as the towns help in easing the economic pressure in the villages. The combination of urban and rural life is beneficial to the town as well as to the village. It serves to diffuse in the countryside a wider knowledge of the outside world and helps the villager to liberate himself from the fetters of custom and prejudice as it enables the townsman to obtain a valuable insight into the realities of Indian life. In these circumstances the Labour Commission give it as their considered opinion that at the present stage the link with the village must be regarded as a distinct asset and that the aim should be not to undermine it but rather to encourage and regularize it.[2]

§5. **The sources of labour supply at some important industrial centres.**—We may illustrate the migratory character of industrial labour by analysing the supply of labour on which some of the more important industrial centres depend.

(i) *Bombay.*—The principle industry of Bombay is the cotton mill industry. Other industries are connected with railway workshops and engineering shops, dockyards, oil and flour mills, tanneries, iron and brass foundries, chemical factories, electric works, printing presses, etc. Bombay is very largely dependent on imported labour: 84 per cent of the inhabitants of Bombay were returned by the census of 1921 as having been born outside

[1] See B. Hurst, *Labour and Housing in Bombay*, Foreword by Sir Stanley Reed, pp. v, vi.

[2] See *L.C.R.*, 17-20.

the city.. The percentage declined to 75·4 in 1931. But there is some doubt as to whether the returns were accurate in this respect. The Deccan and the Konkan, especially the Ratnagiri district, are the chief sources of Bombay's labour supply. Other sources are Kathiawar and Cutch and even such distant provinces as the United Provinces, Madras and the Punjab, and the French and Portuguese Settlements.

(ii) *Ahmedabad and Sholapur.*—The other centres of the cotton mill industry in the Bombay Presidency have a more permanent and less heterogeneous labour force than Bombay. In Ahmedabad the permanent element has been estimated to constitute 20 per cent of the working class population (*L.C.R.*, 13). The Bombay States and Agencies as well as other parts of India contribute the remainder. In Sholapur the proportion of the permanent population is even higher and those labourers who come from outside are chiefly drawn from the neighbouring State of Hyderabad.

(iii) *Calcutta.*—Calcutta with its suburbs where the principal industries, such as the jute mills, are concentrated, relies not only on imported labour like Bombay, but what is more, depends, much more than almost any other centre, on labour from other provinces, such as the United Provinces, Bihar, Orissa, Madras and the Central Provinces. The smaller and decreasing share taken by the Bengali in contributing to the labour supply has been attributed to the fertility of the land and the dislike of the Bengali for factory work.

(iv) *Cawnpore.*—Cawnpore is another important industrial centre and is the principal industrial town of the United Provinces. While the textile industry is the chief industry, there are also tanneries and leather factories, engineering works, oil, flour and rice mills, chemical works, sugar factories, etc. Labour is comparatively plentiful and is freely drawn from the densely populated rural districts which surround Cawnpore. The existence of comparatively satisfactory housing conditions has led to a more settled factory population here than elsewhere.

(v) *Madras.*—The industrial development of Madras has been hampered by its deficiency in coal. It has a few large cotton mills and tanneries and leather factories. Madras depends upon its own local supply of labour to a far greater extent than Bombay, and, in fact, the province as a whole sends out a large number of persons to Burma, Bombay, Bengal, Mysore, Ceylon, etc. 'No less than 95 per cent of the total inhabitants of Madras city were born in the province itself and of these two-thirds were born in Madras itself; and the bulk of the remaining population came from adjacent

districts such as Chingleput and North and South Arcot.' Moreover, the proportion between the sexes is fairly equal, being 897 females to 1,000 males as against 554 females to 1,000 males in Bombay according to the census of 1931. This explains the greater stability of the labour force in Madras as compared with Bombay. The number of industries competing for labour being small, the worker is anxious to stick to the employment he may have got because the chances of his finding alternative employment are slighter here than in Bombay.[1]

§6. **Labour supply in mining centres.**—Mining, especially coal-mining, is an important organized industry in Bengal and the principal industry in Bihar and Orissa. The labour for the Bengal coal-fields is obtained from the backward cultivating tribes of the Santals and Bauris living on the borders of Bihar and Orissa. In Bihar and Orissa, coal-mining is carried on mainly by local labour, though the United Provinces and Central Provinces also contribute to the labour supply. The supply of labour in the mining centres is insufficient and intermittent largely on account of low wages. Only a small proportion of the workers reside permanently at the mines. The rest are usually small cultivators or agricultural labourers who return to their villages for the sowing and harvesting operations.

§7. **Labour supply for Assam tea plantations.**[2]—The tea gardens in Assam, which contain the largest area under tea in India, are 'employment agencies so affected by certain regulations as to make them bear a closer relationship towards industrialism than does general field or farm work'. The Assam Labouring and Emigration Act of 1901 was intended to regulate the system of indentured labour introduced in the thirties of the nineteenth century. It laid down regulations for the supervision of coolie labour on the plantations, and prohibited recruitment except by licensed contractors. However, owing to the prejudice against the contractors and the penal clauses of the Breach of Contract Act of 1859 recruitment continued to be difficult, and this led to the passing of an Act in 1915 which abolished the system of recruitment by contractors. Recruitment could then only take place through agents of the official 'Labour Board' which also inspected the plantations, enforcing regulations which not only limited the term of the contract usually to four years, fixed wages and hours, and prevented the re-engagement of coolies whose indentures had expired (except as free labourers), but also laid down minute instructions as to sanitation,

[1] G. M. Broughton, *Labour in Indian Industries*, p. 141.

[2] For a detailed account of labour conditions on the plantations generally, see *L.C.R.*, chs. xx, xxi.

housing and free medical attendance. In 1920, contracts of more than one year's duration were declared illegal, a provision often disregarded in practice. By the Act of 1920 which came into force in 1926 penal sanction of contracts was abolished. Breach of contract was then a civil and not a criminal offence. The labour is drawn mostly from Bihar, Orissa and the United Provinces.

The recruiting agency is very expensive. Besides money wages the labourers are also given a plot of land, free grazing, etc. and as a class, receive fair treatment.

§8. **The Tea Districts Emigrant Labour Act (1932).**—This Act, passed in 1932 and based on the recommendations of the Labour Commission, extends to the whole of British India including the Santhal Parganas and repeals the Assam Labour and Emigration Act, 1901, and the subsequent amending Acts. The first object of the Act is to make it possible, on the one hand, to exercise all the control over the recruitment and forwarding of assisted emigrants to the Assam tea gardens that may be justified and required by the interests of emigrants and potential emigrants; and, on the other hand, to ensure that no restrictions are imposed which are not justified. Local Governments are empowered, subject to the control of the Government of India, to impose control over the forwarding of assisted emigrants or over both their recruitment and their forwarding as occasion may dictate. Employers are prevented from recruiting otherwise than by means of certificated garden *sirdars* or licensed recruiters. It is made unlawful to assist persons under the age of sixteen to emigrate unless they are accompanied by their parents or guardians. With regard to the question of repatriation, every emigrant labourer on the expiry of a period of three years from the date of his entry into Assam, will have the right of repatriation as against the employer employing him at such expiry; and any emigrant labourer who before the expiry of three years from his entry into Assam is dismissed by his employer otherwise than for wilful and serious misconduct will also have the right of repatriation. It will also be possible to claim repatriation within three years in the event of the emigrant failing in health, not being provided with suitable work, or having his wages unjustly withheld or for any other sufficient cause. Further, repatriation can be ordered at any time by a criminal court in the case of a labourer who has been assaulted by the employer or by his agent. Where an employer fails to make all the necessary arrangements for the repatriation of a labourer working under him within fifteen days from the date on which a right of repatriation arises to an emigrant labourer, the Controller may direct the employer concerned to dispatch such labourer and his family or

to pay him such compensation as may be prescribed within such period as the Controller may fix.

Provision is made for the appointment of a Controller of Emigrants with some staff and possibly one or more Deputy Controllers for supervising the general administration of the system which the Act seeks to establish; and the charges are to be met from an annual cess called the Emigrant Labour Cess which is to be levied at such rate not exceeding Rs. 9 per emigrant as the Governor-General-in-Council may, by a notification in the *Gazette of India*, determine for each year of levy.

The provisions of the Act are intended to apply only to emigration for work on tea plantations in the eight specified districts in Assam in the first instance; but power is retained to extend its application to other industries and to other districts in Assam if necessary.

§9. **Scarcity of industrial labour.**—We have already referred to the alleged scarcity and dearness of labour.[1] The true explanation of any scarcity that may be felt must be sought in the appalling housing conditions in towns like Bombay, the lack of correspondence between wages and cost of living, the absence of a suitable labour-recruiting organization. All these causes have from time to time been reinforced by a sudden shrinkage in the supply of men prepared to brave the various discomforts of life in the cities, on account of the heavy mortality caused by famines, and epidemics like plague and influenza. The migratory character of the industrial labour further emphasizes the feeling of labour scarcity. Skilled labour is particularly difficult to get and this is of course due to the very meagre facilities that exist for training labour for modern industry. The scarcity of men of the *mistry* or foreman class, possessing the requisite technical and business experience, has also been ascribed to 'the average educated Indian's aversion to all forms of manual work'.

According to the Labour Commission, while organized industry in India has throughout the greater part of its history suffered from a shortage of labour, the position has latterly tended to become easier, roughly since 1925. Communications have improved steadily so that labour can now be drawn from a wider area than before. Conditions of life in cities and the factories, although far from ideal, are generally improving. Owing to the spread of knowledge the village population is showing greater readiness to migrate while the pressure on land is showing no signs of abating. Indian factories may therefore be considered as about to be entering on an

[1] See vol. I, ch. iii, §27.

era of abundant labour. Competition among labourers for jobs is becoming keener and keener, which makes it all the more important for labour to organize itself and save itself from the danger of exploitation on the part of the employers (*L.C.R.*, 21-2).

§10. **Factory life in India.**[1]—No greater contrast can be imagined than that between the conditions of life and labour in the villages and those in the towns in India. The agriculturist labourer, who is accustomed to work in the open air along with his family and fellow villagers, finds himself under entirely different conditions in an industrial centre like Bombay, where he must work 'crawling coop'd' under the roof of a factory amidst the din and whir of machinery and in the company of other workers most of whom are total strangers to him. He is, if possible, even more uncomfortable when he returns to his miserable dwelling in a hideous overcrowded *chawl* where anything like real home life is out of the question. The workman is forced to leave his family behind owing to many difficulties, the most serious of which is that of securing accommodation even on the most modest scale for maintaining family life.[2] Sometimes he is lucky enough to secure a job at once through the good offices of a friend. Often, however, he has to wait, and even when he gets employment, it may be only as a *badli* (substitute) for a permanent hand who may be temporarily absent.

§11. **Methods of recruitment.**—In this connexion a word may be said regarding the methods of recruitment. The mill management does not directly recruit the required labour. Personal recruiting by contractors going round the countryside may be necessary in exceptional cases, as in the Assam tea gardens, but it is no longer generally so. Still the foreman or jobber is usually the man through whom the labour is secured (see, however, below) and who continues to act as an intermediary between employer and employee. Some of his functions are like those of trade union officials in the West and occasionally he acts as a strike leader.[3] The jobber manages to make himself indispensable to the workmen in a variety of ways. He lends them money, advises them in family affairs and arbitrates in disputes. Since all labour is recruited through him, the newcomer generally finds that the only way of getting employment, temporary or permanent, is to bribe him. Extensive bribery known as *dasturi* (unacknowledged commission) prevails in the jute mills of Calcutta and petty exactions

[1] For a study of this question, see Matheson, op. cit.

[2] The various restrictions on the employment of women and children also make it difficult for the labourer to bring his family along with him.

[3] The jobber is known in different parts of India by different names, such as *sirdar*, *mukaddam* or *mistry*.

may swell the monthly income of the *sirdar* to four or five times his wages. Even the pay-clerks 'are known to reap harvests of this kind. Women workers also share with men the burden imposed by the overseers, but are particularly liable to be oppressed, especially if they happen to be widows'.[1] In the Bombay cotton mills, it is usual to have women overseers, known as *naikins* or forewomen, in the departments where women work, such as the winding and reeling departments. They are as a class considered to be persons of low morals and often abuse their power over the young girls and women workers under them.

The general prevalence of the system of jobbers has been recognized to be a great evil. The only remedy is stricter supervision by the mill officers and direct control over recruitment, appointments and dismissals. There is at present a close connexion between bribery and turnover. Where the jobber is in the habit of exacting a bribe on all fresh engagements he is interested in seeing to it that such engagements are as numerous as possible and encouraging the movements of the operative from factory to factory. Jobbers should be excluded from the engagement or dismissal of labour. In pursuance of the Labour Commission's recommendation several large organizations such as E. D. Sassoon & Co. and the Burmah-Shell Company have appointed special Labour Welfare officers to recruit labourers and look after their welfare, and it is understood that the system, wherever introduced, has been an unqualified success.[2] Owing to the trade depression a general adoption of this system in place of recruitment through jobbers has not been possible but nevertheless attempts are being made to improve present methods of recruitment. It would be desirable if mills were to show greater willingness to re-engage a worker on his return from a holiday and thus help him to remain loyal to his mill. A system of regular leave and holiday allowances should be introduced as this would tend to diminish the power of the jobber and create a contented and efficient labour force.[3]

The Government of Bombay have under their consideration the feasibility of legislation for leave with pay during periods of sickness.[4]

§12. **Periods of wage payments.**—In most Bombay mills wages are paid once a month, usually on the fifteenth of the month next following the one for which wages are earned, so that a new recruit

[1] J. H. Kelman, *Labour in India*, pp. 108-9.
[2] *Indian Year Book*, 1937-8, p. 504.
[3] *L.C.R.*, 23-7.
[4] *Labour Gazette*, Bombay, August 1937, p. 923.

has to wait for six weeks before he can get his wages. This is a source of much hardship and accounts for a large part of the indebtedness of the factory population. In fact, indebtedness is as much a feature of town life as of village life. The millowner on his part pleads that holding wages in arrears is the only method of preventing his labour force from deserting him without notice. The system of monthly payments necessitates at least one month's notice from a workman desiring to leave. Many new workmen, ignorant of this, leave without notice and thus forfeit a month's pay. Generally speaking the longer the wage period, the more delayed is the payment of wages. In the Calcutta jute mills, weekly wages are paid and only a week's wages are held back. In Ahmedabad, wages are paid by the *hapta* or intervals of fourteen to sixteen days.

Local Governments were asked in September 1924 to collect information on the periods of wage payments and this revealed the most striking absence of uniformity as to the method adopted from industry to industry and place to place. Even within the same establishment different systems may be found.[1] The Payment of Wages Act which was passed in April 1936, and came into force in March 1937 provides (i) that no wage period shall exceed one month,[2] (ii) that all wages must be paid in coin and/or currency notes and, (iii) that the wages of any person employed upon or in (*a*) any railway factory or industrial establishment employing more than 1,000 persons shall be paid before the expiry of the seventh day, and (*b*) in any other railway, factory or industrial establishment, shall be paid before the expiry of the tenth day, after the last day of the wage-period in respect of which the wages are payable.

§13. **Deductions from wages.**—The Payment of Wages Act referred to in the preceding section seeks to regularize and restrict deductions from wages. Only certain deductions are allowed, e.g. :

Deductions from the wages of an employed person may be of the following kinds only, namely, fines; deductions for absence from duty; deductions for damages to or loss of goods expressly entrusted to the employed person for custody, or for loss of money

[1] The information has been published in *Periods of Wage Payment* [Bulletins of Indian Industries and Labour, No. 34 (1925)].

[2] Amendments to the Payment of Wages Bill, moved by Labour members to reduce the wage period to a week or fortnight were defeated, owing mainly to the opposition of the monthly-paid workmen, who argued that if rents and bills were to be settled monthly, they would be in difficulties if they had frittered away their weekly or fortnightly earnings.—*Indian Year Book*, 1937-8, p. 510.

for which he is required to account, where such damage or loss is directly attributable to his neglect or default; deductions for house-accommodation provided by the employer; deductions of subscriptions to, and for repayment of, advances from any provident fund, etc.

Fines.—Fines can only be imposed on any employed person for certain specified acts and omissions on his part notified in the prescribed manner on the premises in which the employment is carried on. The total amount of fine which may be imposed in any one wage-period shall not exceed an amount equal to half an anna in the rupee of the wages payable to him. No fine shall be imposed on any employed person who is under the age of fifteen years.

The Payment of Wages Act may thus be looked upon as an advanced and difficult piece of social legislation in India.

§14. **Hours of work and the loitering habit.**—We shall discuss the statutory regulation of the hours of work under the various Factories Acts in the section dealing with labour legislation. Before summarizing the existing hours of work in all factories in India, we may refer to one controversial aspect of the Indian factory worker, viz. his alleged habit of loitering. Although the Factory Act of 1911 limited the hours of work to twelve per day for adult males in the textile factories, the Bombay millowners pleaded that the real hours worked were about eight owing to want of continuous and rigid application to duty. In fact one of the grievances of the employers of labour in India has always been that the Indian mill-hand is incapable of steady and continuous work. He is given to loitering and loafing away his time under various pretexts. Men are often found to be absent from their machines, and spare hands have to be employed to attend to the machines of the idlers. The Indian Factory Commission (1908) declared that, 'while the Indian factory worker may work hard for a comparatively short period, his natural inclination is to spread the work he has to do over a long period of time, working in a leisurely manner throughout and taking intervals of rest whenever he feels disinclined for further exertion'. The excessively long hours of work—twelve to fourteen hours—which prevailed, especially before the passing of the Factory Acts of 1911 and 1922, are held to be the chief cause of loitering. Dr T. M. Nair in his Minute of Dissent to the Report of the Factory Commission calls it 'a manifestation of the adaptive capacity, which all human beings possess more or less, a device to reduce the intensity of labour as a safeguard to his physical well-being'. Climatic conditions, feeble physique and the agricultural interests of the

labourer are also suggested as other causes. With the reduction in the hours of work, improved sanitary conditions, ventilation in factories, and better supervision through the institution of the pass system, the loitering habit will be largely checked, and efficiency of labour enhanced. There is, for example, less loitering in the Calcutta jute mills, where labourers work in shifts for shorter hours, and in the engineering shops, where also the working day does not exceed eight hours.

The following summary table regarding the hours of work in all factories in India in the year 1935 will be found interesting in this connexion.[1]

Types of factories and sex groups	Percentage of factories in which normal weekly hours are		
	Not above 42	Between 42 and 48	Above 48
Perennial :—			
For men	7	23	70
For women	15	8	67
Seasonal :—			
For men	27	13	60
For women	35	11	54

Under the Factories Act of 1934, no child is to be employed for more than 30 hours in any one week. In the year 1933 the position was that out of the 919 factories employing children, 367 had hours below 30 for children and 552 above 30. In consequence of the lessening of the hours of work for children so much improvement in their efficiency has occurred that no reduction in their wages has resulted.

§15. **The evil effects of the employment of women and children.**— The employment of women and children in factories gives rise to some of the most serious evils of modern industrialism and leads to special hardships in the circumstances of India.[2] The life of a married woman engaged in a factory is very hard as she is wage-earner as well as domestic drudge of the family, and the excessive pressure of work leads to serious nerve and tissue waste. The children are mostly left to themselves as very few factories provide

[1] *Statistics of Factories for the year ending 31 December 1935*, p. 3 and *Indian Year Book*, 1937-8, p. 507.

[2] The housing difficulties in industrial towns, compelling many men to live single, account for the small percentage of women and children employed in Indian factories. In 1935, out of the total number of 1,610,921 persons employed in factories in British India, 229,710 were women, 33,002 adolescents (5,634 being females), and 15,462 children.

crèches. The absence of maternity benefits and the usual over-exertion to which she is subjected right up to confinement and which begins again almost immediately after, work further havoc with the health of the female labourer (see §47, however). The absence of suitable medical facilities is another great hardship.

The employment of children is even more liable to abuse. Before the Factory Act of 1922 children certified to be nine years of age were allowed to be employed seven hours daily. In practice this age-limit was much lower owing to the difficulty in ascertaining the age correctly and the abuse of the Age Certificate system. The law was also evaded in some cases by the children working in two mills. Factory inspectors found it an impossible task to control these abuses. Hence the Factory Act of 1922 raised the age-limits of half-timers to twelve and fifteen and reduced the hours of work to six, in the hope that the results of the possible evasion of the law through false declarations of age would be less serious than under the old system. Another important reform introduced in Bombay was the appointment of whole-time surgeons. In all provinces there is now an increasing efficiency of arrangements for the certification of children. The amendment of the Factory Act in 1926 made parents and guardians responsible for the double employment of children under two certificates. The Factories Act of 1934 introduces a new group of adolescents over 15 and under 17 years of age to be deemed as children, if not certified as fit for adult employment (see §33 below). The number of children employed in factories has thus steadily fallen from 74,620 in 1923 to 15,457 in 1935. In the textile mills in Bombay city there are none. It is perhaps necessary to add that the enhanced age-limits should be utilized to give suitable education to the children.

§16. **Trying conditions of work in the mills.**—In the interests of the health and efficiency of the operatives, special attention is necessary to such matters as ventilation, the regulation of humidification in factories, arrangements for meals, bathing and latrine accommodation, etc. Conditions in all these respects are gradually getting better, but there is still ample scope for improvement. The problem of ventilation is one of light and free air in motion and presents special difficulties in cotton mills, which in large cities like Bombay are built in blocks of several storeys, where roof light is not possible except on the top floor. 'Experiments that have been made show a fall in efficiency during the hot weather in an ill-ventilated weaving shed as reaching twenty per cent.' Humidification presents another difficult problem. India does not possess the advantage of the naturally humid climate which is required for the spinning and weaving of cotton. To avoid breakage of thread

and loss of material, artificial humidification of factories is therefore necessary. Such humidification, especially when effected by letting in steam and the use of impure water, is injurious to the health of the operatives. The Government of India have taken a step in the right direction by the appointment of an expert adviser on humidification to ensure the adoption of the best possible methods.

In most mills and factories in India, there are no proper arrangements for the meals of the operatives. The meal is hurriedly prepared in the morning and carried to the factory either by the workman or brought to him later by a messenger. It is eaten in the open factory yards, weather permitting, or else inside the machine sheds. A very small number of mills, such as the Buckingham and Carnatic Mills in Madras, have supplied dining sheds for the different caste people employed by them. There is an urgent need for suitable canteens which can be patronized by workers of both sexes. This will also lessen the strain on the woman worker and make the midday recess a real time of rest for her. Supply of pure drinking water, arrangements for bathing, so essential in a hot country, and sanitary latrine accommodation, are further points in regard to the conditions in factories to which the employers of labour have not yet learnt to attach sufficient importance as increasing the comfort of the worker and improving his efficiency. The Government of Bombay in their recent Press Note regarding their labour policy propose to make satisfactory dining accommodation and adequate medical aid a legal obligation on employers.

§17. **Absenteeism in Indian factories.**—The large percentage ot absenteeism among the operatives in India makes smooth working of the factory extraordinarily difficult. The millowners assert that there is an increase in absenteeism after increase of wages or payment of wages and bonus, and that the worker is satisfied when he has earned enough to keep body and soul together. The percentage of absenteeism (which in the case of Bombay varies on an average from eight to twelve per cent) shows seasonal variations, reaching its maximum in the monsoon months and the festival and marriage seasons, being thus highest from March to June and lowest in December and January. In Calcutta there is a large annual exodus in the hot season because the jute industry season is slack after winter and because the climate in the early part of summer is particularly trying.

Absenteeism on this scale necessitates the maintenance of an excessively large muster roll and leads to the employment of inferior substitutes casually recruited, and therefore to inferior work. It is, however, not easy to suggest remedies. Attendance allowances have been tried with some success. The Textile Tariff Board

suggests the formation of labour reserves which would make a casual *badliwala* unnecessary and also facilitate the grant of leave (*Report*, par. 60).

The rapid turnover of labour in factories is another drawback, and is closely connected with absenteeism.[1] The personnel of the workers in mills in industrial centres like Bombay, Madras and Nagpur changes almost completely in about a year and a half on an average. There is thus a needless increase in the costs of production and the efficiency of the workers suffers.

§18. **Efficiency of industrial labour.**—The position as regards the alleged inefficiency of Indian labour needs to be clearly stated. Indian labour is generally regarded as much less efficient than European labour. If by this we mean that the European labourer is capable of turning out much more work than the Indian labourer in a given time, it will not be possible to contradict such a statement. In his evidence before the Industrial Commission, Sir Alexander McRobert stated that the English worker was 3·5 or even four times as efficient as the Indian. Sir Clement Simpson calculated that 2·67 hands in an Indian cotton-spinning and weaving mill are equal to one hand in a Lancashire mill. Dr Gilbert Slater, however, points out that, in this calculation, the inferiority of the Indian worker is overstated. The difference in the number of weavers employed to attend one loom in India and England does not by itself provide an accurate measure of the difference in efficiency between Indian and English labour. In India, a large number of workmen are employed because the value of the additional output is greater than the increase in the wage bill. In England, wages being much higher, economy in the number of workmen employed is imperative. Dr Slater, however, admits that though the inferiority of Indian labour is generally exaggerated, it is real enough, and indeed, it need cause no surprise if we remember the much superior physique, the greater intelligence, amenability to discipline and capacity for steady continuous toil of the English labourer. It is, however, necessary to accept with caution pseudo-mathematical statements such as those alluded to above. The problem of the relative efficiency of English and Indian labour cannot be solved by the 'method of difference' because of the entirely dissimilar conditions of work. The smaller outturn in an Indian mill

[1] Dissatisfaction with hours of work or wages leads to changes from one mill to another and the absence of standardization of wages intensifies the motive to change (Das, op. cit., pp. 44-5). The activities of the jobber going from mill to mill in search of labour are also held to be partly responsible for the evil, which Government employment bureaux may mitigate to some extent.

cannot be wholly put down to the inferiority of the Indian operative, for his lower productivity may partly be the result of relatively inefficient management. Moreover, as the textile workers in Bombay pointed out in 1889 in their petition to the Governor-General, the Indian operative is handicapped by the badness of the raw material used in Indian mills. Owing to the inferior quality of the cotton, there is continuous breakage in thread and more men have thus to be employed. It is also complained that, unlike the Lancashire millowners, the millowners in India do not use the most up-to-date labour-saving devices and machinery. One reason for this is that all machinery has to be imported from abroad, which makes it much more expensive than in England, and, as wages are lower in India, this often determines the balance in favour of employing more hands rather than investing in the most up-to-date machinery and the latest labour-saving appliances. The employers cannot indeed be blamed for this, but it certainly renders the comparison between English and Indian labour unfair to the latter.

Granting, however, that the Indian labourer would almost certainly be found to be inferior in the sense that his output would be smaller, even if other things such as the nature of machinery employed, etc. were the same, the next question to be answered is whether Indian labour is also inefficient in another sense which depends on the relation between the work turned out and the wages paid. The Industrial Commission thought that Indian labour does not produce as cheaply as Western labour in spite of its lower wages. Dr Nair argued in 1908 that ' if one Lancashire operative is equal to 2·67 Madras operatives, then, since the average monthly wage of a Lancashire operative is about Rs. 60 (£4), while that of a Madras operative is only Rs. 15 (£1), it is clear that for the same money the Indian millowner gets nearly double the work that an English millowner does '.[1] This, however, amounts to saying that Indian labour is actually more efficient than English labour (taking efficiency in the second sense of the term), which is almost certainly untrue; and friends of Indian labour should note that it proves too much from their point of view, for if Indian labour is already twice as efficient as English labour (which, perhaps with the exception of American labour, is generally regarded as the most efficient in the world), why trouble about making it still more efficient, say, by means of higher wages and the consequent improvement in the standard of living? The case for better wages is clearly weakened by such tactless defence of Indian labour. But apart from any tactical considerations, we think that, broadly

[1] P. P. Pillai, *Economic Conditions in India*, p. 224.

speaking, at the present time, the principle of the economy of high wages will be found to apply to Indian labour, so that increased wages are likely to result in a more than proportionate increase of efficiency and that, however we conceive the matter, the present position is that Western labour is incomparably more efficient than Indian labour,[1] though Indian labour has been improving slowly but steadily.

§19. **Causes of the inefficiency of Indian labour.**—As regards the causes of the inefficiency, their name is legion. Some of them are permanent while others are temporary or remediable. To the former class belong the climatic conditions in India which are generally adverse to high labour efficiency. Thinking of the cotton industry we may note that Lancashire possesses a great advantage in its cold and invigorating climate, denied to most parts of India where the industry is located. Again, the artificial humidification which is necessary in India is at best a poor substitute for the naturally moist climate of Lancashire and is liable to inflict serious injury on the health of the operatives unless it is properly regulated. The causes susceptible to remedy, such as the very unsatisfactory conditions as regards ventilation and sanitation, etc. have already been referred to. Further, it may be urged that the hours of work, although shortened recently by legislation, are still much too long, especially for a tropical country, and there is probably much truth in the suggestion that the slackness and listlessness of the Indian worker are a kind of protective device which he unconsciously adopts to prevent the constitutional breakdown which strenuous labour for the long hours of work would otherwise inevitably bring about.

It is undoubtedly a fact that the physique of the average Indian worker is inferior to that of an average English worker. This is due especially to two causes, (i) the ravages of disease, and (ii) a poor dietary. While, as we have seen, the rural areas are by no means free from the ravages of major diseases like malaria, plague, cholera, influenza, kala-azar, hook-worm, etc. their incidence is especially heavy in congested industrial areas. The terrible slums where the labourers have to reside are first-rate breeders of

[1] Mr (now Sir) H. P. Mody, Chairman of the Bombay Millowners' Association, in his oral evidence before the Labour Commission, gave the following figures relating to comparative labour efficiency: 'In Japan a weaver minds six looms and efficiency there is 95 per cent. In China a weaver minds four looms and efficiency is 80 per cent. In Bombay a weaver minds two looms and efficiency is 80 per cent. Calculated on the basis of Japan and China a weaver in Bombay is paid between 200 and 300 per cent more than a weaver in Japan or China.'

pestilence and provide almost ideal conditions for its rapid spread.

An organization for the improvement of public health, which would include the supply of pure water, unadulterated food, and a proper drainage system, is absolutely necessary along with better medical facilities and a system of insurance against sickness of industrial workers.

As regards the effects of a poor dietary, this is a question which concerns the whole Indian population and will be discussed in Chapter IV.

§20. **Conditions of housing.**—The unbelievable overcrowding and appalling conditions of sanitation in most of our industrial towns have much to answer for in respect of the instability of labour in the towns and its low efficiency. In some of the industrial areas in India where factories have been established at some distance from the towns, the problem of housing and sanitation is comparatively simple. The labourers are often housed in the neighbouring villages or in dwellings that take the form of single-storey 'lines' erected by the employer, who can acquire the necessary land without much difficulty. The second stage of development and congestion is typified by such cities as Madras, Cawnpore, Nagpur, Ahmedabad, and in a very large proportion of industrial areas round Calcutta. In these areas land is far cheaper than in Bombay and Calcutta proper, and accommodation usually consists of single-storey huts in groups known as *bastis*, erected by persons other than the owners of mills and rented to mill-hands on fairly reasonable terms. In some cases, as at Cawnpore, Calcutta and Ahmedabad, the more enlightened factory owners have found it advisable to supply housing accommodation to the employees in the hope of commanding the pick of the labour market, especially in the case of such fluid labour force as that on which the textile factories rely. Conditions in Ahmedabad ought to be better as land is cheaper than in the other cities, but actually the condition of housing in Ahmedabad appears to be worse than in any other industrial centre in India. However, the Municipality has recently decided to construct model dwellings for workers and the question is also being tackled on co-operative lines. In practically every industrial centre the evil of overcrowding has been allowed to grow, no control having been exercised over the selection of sites for industrial development.

This has naturally led to a shocking state of affairs. 'The majority of the working classes are housed in *chawls* or tenements which consist usually of single rooms, sometimes of double rooms or *gallas*, but never of more than two rooms. These *chawls* have

for their object the housing—one is almost tempted to use the expression "warehousing"—of large numbers of the labouring classes in as cheap a manner as possible."[1]

The vast majority of the working class families in Bombay live in single rooms (more than 70 per cent). The average number of persons per room in the case of working class quarters is 4·03. These figures stand in striking contrast to those of London, where only 6 per cent of the total population live in one-room tenements with an average of 1·92 persons per room. It must also be remembered that the practice of sub-letting is common among industrial workers in Bombay. This of course causes further overcrowding. Although the *chawl* is a special abomination of Bombay, the evil of congestion and overcrowding is by no means unparalleled in other centres. The overcrowding in certain parts of Howrah, for instance, is probably unequalled in any other industrial centre in India. Even smaller industrial towns are showing the same tendency.

§21. **The adverse effects of bad housing and sanitation.**—'Good houses mean the possibility of home life, happiness and health; bad houses spell squalor, drink, disease, immorality, crime, and in the end demand hospitals, prisons and asylums in which we seek to hide away the human derelicts of society that are largely the results of society's own neglect.' Insufficient and bad housing is also one of the factors responsible for industrial unrest. All these evils are present in varying degrees in Bombay. One of the greatest evils is the heavy infant mortality in the Bombay slum areas. The rate of mortality varies inversely with the number of rooms in the dwelling-place. The highest rate reached in the worst localities is 298 per 1,000 registered births as against the average rate of 200 to 250 for the general population.[2] Lastly, the appalling conditions of *chawl* life and the absence of privacy have also a deterrent effect on those who wish to bring their families with them to the towns and have thus, in general, a very unsettling effect on the stability and efficiency of labour.

§22. **Attempts at improved housing.**—In Bombay, while water-supply, sanitation and drainage were improved, no heed was given for a long time to the removal of congestion and the destruction of the slums, so that the position became worse and worse every year. The heavy mortality and the great exodus from Bombay that followed in the wake of the great plague of 1896 and the consequent paralysis of trade and industry brought matters to a head, and the Bombay Improvement Trust was established in 1898

[1] Hurst, op. cit., p. 20. See also *Industrial Commission Report*, par. 241.
[2] *L.C.R.*, 271.

to make new streets, open out crowded areas, reclaim land from the sea providing room for expansion, and construct sanitary dwellings for the poor and the police. The limited powers and funds of the Trust and want of proper co-operation between the Trust and the Corporation, and its inevitable unpopularity brought on by compulsory acquisition of private property and demolition of buildings, prevented rapid progress and led to the adoption of the policy of ' slum-patching '. Nevertheless the Trust did some highly useful work.

The Municipality also had by 1920 provided 2,900 tenements for its staff and had sanctioned the construction of another 2,200. The Port Trust had provided quarters for nearly 5,000 of its employees. In the meantime, the population of the city was increasing rapidly and the millowners did little in the matter of housing their operatives. By way of preventing further congestion and securing better housing, the Industrial Commission recommended refusal of permission, with a few exceptions, to establish fresh industrial concerns;[1] the setting up of a special area for industrial development; the removal of the existing railway workshops to a reasonable distance from the city; supply of housing accommodation to their employees by railways, Government Departments and public bodies; improved communications with the object of creating industrial suburbs; a definite standard of accommodation for industrial dwellings located in the city; and a programme of construction worked out and taken up by Local Authorities. At the end of the War, a bold and comprehensive scheme of a Development Directorate to deal with the problem was drawn up by the Bombay Government. The funds were derived from the proceeds of a development loan of Rs. 9 crores and a ' town duty ' of one rupee per bale of cotton on all cotton entering Bombay. However, a large number of the tenements built, especially the *chawls* at Worli, remain unoccupied. From an architectural point of view they are profoundly ugly and their inability to attract the workers has been attributed to difficulties of access, absence of bazaar facilities, cement construction (which makes the rooms uncomfortably warm in hot weather and uncomfortably cold in cold weather), high level of rents, lack of lighting and lack of police protection. Some attempts are being made to correct these defects. The Municipality and the Port Trust are also carrying out their programme of development, and the Port Trust have constructed a new cotton depot at Sewri.

[1] This suggestion has been accepted and no new mills are allowed to be erected in the town of Bombay proper.

So far as the millowners are concerned, some mills, like the Jacob Sassoon Mill, have provided housing accommodation to their operatives. The difficulty of procuring land on moderate terms in the vicinity of the factories, the absence of any guarantee that the operatives housed by a mill will not accept work in other mills, and the reluctance of the operatives themselves to take advantage of such arrangements, have made progress inevitably slow. The operatives fear loss of liberty of action and probable ejectment in case of strike, and resent sanitary rules and discipline, the value of which they do not understand. More favourable conditions in these respects exist at Cawnpore, Nagpur, Ahmedabad and Madras, where the millowners have taken greater interest in the housing of their operatives, with considerable advantage to both parties. Special mention may be made of the magnificent scheme of industrial housing launched by the Empress Mills at Nagpur managed by Messrs. Tata Sons, Ltd., and the housing scheme at Jamshedpur for the staff and employees of the Tata Iron and Steel Company Ltd.

The Labour Commission made a variety of suggestions. They recommended that (i) the Land Acquisition Act should be amended so as to enable owners of industrial concerns to acquire land for the erection of workers' dwellings. (Accordingly, on the initiative of the Government of India, the Act was amended in 1933); (ii) Provincial Governments should make a survey of urban and industrial areas to ascertain their needs with regard to housing and arrange for mutual consultations for devising practical plans of co-operation among all interested parties; (iii) the Government should lay down minimum standards in regard to cubic space, ventilation, lighting, water-supply, drainage, etc.; (iv) suitable town-planning Acts should be passed wherever necessary; (v) the provision of working-class housing should be a statutory obligation on every Improvement Trust; (vi) co-operative building societies should be encouraged; (vii) municipalities should revise, bring up to date and enforce rigorously by-laws dealing with health, housing and sanitation (*L.C.R.*, ch. xv).

The problem of industrial housing bristles with difficulties connected with finance, management, design, etc. not the least of which arises from the total indifference of the workers themselves to the necessity of clean and sanitary housing. Proper education of the workmen in elementary hygiene, and as far as possible the approximation of industrial dwellings to conditions obtaining in the villages, ought to go a long way towards ensuring clean and suitable dwellings and securing the stability of industrial labour.

§23. **Wage rates.**—The Labour Office of the Government of Bombay conducted four inquiries into the wages of workers in

the cotton mills in the Bombay Presidency in 1921, 1923, 1926 and 1934.[1] The Government of Bombay in 1934 launched a comprehensive General Wage Census, which is intended to be completed in about five years, in order to collect all possible information on the subject of wages in all types of industrial concerns in the Bombay Presidency. The wage census is being conducted by the Labour Office in Bombay. It has been directed first to make a survey of wages and conditions of work in the factory industries in two parts, Part I covering all perennial factories, Part II seasonal factories. So far three Reports have been published. The first deals with engineering concerns and occupations, the second with the printing industry and the third with the textile factories in the Presidency.[2]

According to the Wage Census now being carried out in the Bombay Presidency, the average daily earnings of all the adult operatives in all occupations in the Cotton Textile Industry in the Bombay Presidency in 1934 were as follows: Re. 1-1-10 in Bombay city;[3] Re. 1-0-3 in Bombay Suburban, Thana, Kolaba and Ratnagiri Districts; Re. 1-5-7 in Ahmedabad city; Re. 1-0-3 in Ahmedabad, Kaira and Panch Mahals; Re. 0-14-0 in Broach and Surat; Re. 0-12-0 in East and West Khandesh; Re. 0-15-7 in Poona, Nasik and Ahmednagar; Re. 0-11-8 in Sholapur city; Re. 0-7-6 in Sholapur and Satara and Re. 0-8-7 in Belgaum, Bijapur, Dharwar and Kanara.

The average monthly earnings for men in all Engineering and 'Common' occupations excluding unskilled labourers (all factories) according to the Wage Census taken in Bombay were as follows:—

Rs. 41-8-5 in Bombay city, Rs. 43-2-11 in Bombay Suburban, Thana, Kolaba and Ratnagiri;[4] Rs. 33-7-4 in Ahmedabad city; Rs. 52-12-7 in Ahmedabad, Kaira and Panch Mahals; Rs. 32-1-10 in Broach and Surat; Rs. 26-7-9 in East and West Khandesh; Rs. 29-1-7 in Poona, Nasik and Ahmednagar; Rs. 22-1-4 in Sholapur city; Rs. 24-2-1 in Sholapur and Satara; and Rs. 34-13-7 in Belgaum, Dharwar, Bijapur and Kanara. The average for the Presidency was Rs. 38-3-3.

In the jute industry in Bengal the average monthly wages of the different classes of employees vary from Rs. 40, for example

[1] *Wages and Unemployment in the Bombay Textile Industry* (1934).

[2] *Labour Gazette* (Bombay), July 1937, p. 681.

[3] Wages in the Bombay mills in October 1934 were lower by 16 per cent as compared with July 1926.

[4] The average percentage attendance was higher in these districts, being 90 per cent as compared to 87·6 per cent in Bombay city. *Report on the General Wage Census* (Bombay), Engineering Industry, Part I, p. 97.

metal turners (we exclude Chinese carpenters, who earn as much as Rs. 93 per month), to Rs. 11, for example bobbin cleaners. Wages are appreciably higher in the case of workers in the single-shift system than in that of workers in the multiple-shift system.

The daily earnings of underground workers in the more important coal-fields in British India vary according to locality from Re. 1-7-0 to about 13 annas for foremen, *sirdars*, etc., from 14 to 8 annas for miners and from 12 to 6 annas for loaders. In the case of other underground workers the rate of wages depends on whether they are skilled or unskilled. Females working underground do not seem to be able to make more than about 6 annas per day.

The general scale of wages is lower for workers engaged on open workings' and lowest for labourers working on the surface. On the tea plantations in Assam the family has to be taken as the working unit and the monthly cash earnings of an average family vary considerably according to districts, being apparently highest (about Rs. 32) in Dibrugarh District and lowest (about Rs. 15) in the Cachar, Sadr and Hailakandi Districts.

§24. **Low standard of living.**—The low standard of living of the Indian labourer may be regarded as a further cause of inefficiency. It is both the cause and the effect of the low wages. In conformity with the rather obvious generalization known as Engel's Law we find that the average income of the worker in India being very small, a very high percentage of it is spent on food and that the percentage decreases with the increase in the size of the income. In Bombay, for example, the Report on the inquiry into working-class budgets in Bombay in 1921-2 showed that the expenditure on food varied from 60·5 per cent in the case of incomes below Rs. 30 per month to 52·6 per cent in the case of incomes between Rs. 80 and Rs. 90 per month. In countries with a high standard of living, like England and the United States, a comparatively much smaller proportion of the wage-earner's income is absorbed by food and the other elementary necessities of life and more is left over for conventional necessaries and luxuries.[1] The standard of living of the Indian worker falls far short of what is required for full efficiency and is barely enough for sustaining his family.

The Report on the latest inquiry into the working-class budgets in Bombay city conducted by the Labour Office in 1932-3 shows that the average monthly expenditure of the family is Rs. 45-15-9. Except in the income groups 'below Rs. 30' and 'Rs. 30 to Rs. 40'

[1] G. Findlay Shirras, *Working Class Budgets in Bombay* (Bombay Labour Office, 1923).

the income is in excess of the expenditure and in the income group 'Rs. 90 and over' the surplus left at the end of month is about 22·5 per cent of the monthly income. It is important to remember that this was the position at the time of the inquiry, and the wage-cuts which have taken place since then, especially in the cotton mill industry, may have tended either to affect the monthly surplus or lower the standard of living. The following comparative data regarding the distribution of expenditure on the various groups of commodities and services which comprise a family budget, would serve to indicate the life of working classes at different centres in India.[1]

Percentage Distribution of Expenditure

Groups	Bombay (1932-3)	Ahmedabad (1926)	Sholapur (1925)	Nagpur (1927)	Jubbulpore (1927)	Rangoon (1928)
Food	46·60	57·90	49·25	64·10	66·00	52·7
Fuel and lighting ...	7·11	7·04	9·60	9·62	7·95	5·2
Clothing, footwear, etc. ...	7·75	9·45	11·86	10·70	10·86	10·6
House-rent	12·81	11·74	6·27	1·92	1·44	13·9
Miscellaneous[2] ...	25·73	13·87	23·02	13·66	13·75	17·6
	100·00	100·00	100·00	100·00	100·00	100·00

The average monthly income of the family of a working-class family is Rs. 50-1-7 in Bombay, Rs. 44-7-2 in Ahmedabad, Rs. 39-14-10 in Sholapur, and Rs. 58-8-3 in Rangoon. With incomes of this order it is clearly impossible to maintain any satisfactory standard of living. The worker cannot afford sufficient wholesome food, even supposing he utilizes his income with the most complete wisdom. We have already described his sorry plight as regards shelter. His clothing is too scanty even for a warm climate. The expenditure on education is almost nil. The only furniture he can afford is limited to a few rough deal-wood boxes, iron plate trunks, bamboo sticks, a country blanket, a worn-out mat, a few knick-knacks and cheap chromolithographs representing scenes from mythology.[3] Most workers have to spend a considerable proportion

[1] *Report on an Inquiry into Working Class Family Budgets in Bombay City* (1935), p. 19, and *The Indian Year Book*, 1937-8, p. 520. The figures are not *strictly comparable* owing to differences in the items included in the different groups. They are nevertheless useful in giving a general indication of the variations in the distribution of expenditure.

[2] The miscellaneous group of expenditure, it should be noted, includes such items as interest on loans, liquor, travelling to and from villages, etc.

[3] Hurst, op. cit., p. 63.

of their incomes on travelling to and from their villages. Another large part goes to meet the interest on the debt they have almost invariably incurred.[1] The usual rate of interest charged is one anna per rupee per mensem, or seventy-five per cent per annum, and compound interest is charged if the interest is not paid regularly. The interest on debt shows an average expenditure of nearly three per cent of the total monthly expenditure.[2]

§25. **Expenditure on drink.**—The evil of drink is spreading in an alarming fashion among the factory labourers, and it is believed that at least four per cent of the total expenditure of the working classes, as shown by family budgets, goes on drink, the percentage being as high as ten in the case of the lowest class of workers like scavengers. The male worker (women rarely drink) frequently tries to relieve by drink 'the hard and long day's work in the mill under the scorching humid heat of an eastern sun' (Hurst). There is some physiological connexion between craving for drink on the one hand and unwholesome conditions of work and malnutrition due to poverty on the other. The provoking part about the matter is that if the money spent on drink were to be used for buying more and better food, there would, of course, be less malnutrition. The worker is not only extremely poor, but is also unable to manage his expenditure in the best possible manner, and the expenditure on drink serves to aggravate his poverty which in its turn leads to an increase of drunkenness. Among remedies being tried are the substitution of tea shops, cinemas, clubs and other forms of recreation for the tavern, and the curtailment of the number of liquor shops and the hours of opening, along with rationing in mill areas. In this connexion reference may be made to the policy of prohibition recently (1937) announced by the Congress ministries in Bombay, Madras and other provinces. The Government of Bombay propose to select important industrial towns for the early application of the policy.

§26. **Case for higher wages.**—With reference to the prevailing wage rates in India the opinion may be hazarded that an increase of wages is necessary as a first step in order to key up labour to a higher state of efficiency. In India as elsewhere, employers are often found urging that increase in wages is either dissipated in drink or leads to greater idleness on the part of the labourer, instead of raising his standard of living, and that consequently

[1] According to the inquiry in 1923 into the working-class budgets in Bombay by the Labour Office, forty-seven per cent of the families were in debt and the debt was the equivalent of two and a half months' earnings (one month's average earnings per family being Rs. 52-4-6).

[2] See also §28.

there is no improvement in his efficiency. Professor Pigou effectively disposes of this objection to higher wages as follows:

'It is true that at any given moment the taste and temperament of persons who have long been poor are more or less adjusted to their environment and that a sudden and sharp rise of income is likely to be followed by a good deal of foolish expenditure, which involves little or no addition to economic welfare. If, however, the higher income is maintained for any length of time, this phase will pass, whereas if the increase is gradual, . . . the period of foolishness need not occur at all. In any case, to contend that the folly of poor persons is so great that the rise of income among them would not promote economic welfare in any degree, is to press paradox beyond the point up to which discussion can reasonably be called upon to follow.'[1]

Another standard objection to raising the rate of wages is that the effect is likely to be very soon cancelled by an increase in population. This point has already been dealt with (see vol. I, ch. iii) and we have advanced the view that increase of wealth, although it may express itself partly in increase of numbers, may also be expected partly to result in raising the standard of living. It is not seriously disputed that the standard of living of industrial labour has in fact risen appreciably in recent years.

The conditions of international competition are also alleged to be a formidable obstacle to the levelling up of wages. We have already referred to the difficulties of the cotton mill industry, undoubtedly due in some measure to the severity of competition from Japan. The fact that a country may gain a substantial advantage, at least temporarily, over another by sweating its workers may be admitted. At the same time, it does not follow that other countries also must in self-defence adopt similar methods of sweating. It is arguable that sweated trades do not pay in the long run as they lead to diminished efficiency. In any case, no civilized community can afford to forget that, equally important with the economic ideal of increase of production, is the moral ideal of increase in the quality of human life. The proper method of equalizing conditions of international competition is to get every nation to agree to secure certain minimum conditions of working. But even when a particular nation remains recalcitrant, protection against it must be sought in other ways than by imposing or acquiescing in a dangerously low standard of living for the workers.

The Government of Bombay recently (September 1937) appointed the Bombay Textile Labour Inquiry Committee, to examine, among

[1] A. C. Pigou, *Economics of Welfare*, pp. 53-4.

other matters, the wages paid to workers having regard to the hours, efficiency and conditions of work in the various cèntres of the textile industry in the province, and to inquire, in this regard, into the adequacy or inadequacy of the wages earned in relation to a living wage standard. The Committee in an interim report issued in February 1938, has recommended an immediate increase in the wages of the mill worker in the Bombay Presidency in view of the decided improvement in the industry since 1937.

§27. **Legal minimum wage.**—The Eleventh International Labour Conference held at Geneva in 1928 adopted a draft convention providing for the creation and maintenance of a machinery whereby minimum scales of wages can be fixed for workers employed in certain of the trades (and in particular in home industries) in which no arrangements exist for the effective regulation of wages by collective agreement or otherwise, and in which wages are exceptionally low. The Labour Commission suggest that before minimum wage-fixing machinery can be set up, industries in which there is a strong presumption that the conditions warrant detailed investigation should be selected and a survey of the conditions in each such industry should be undertaken as the basis on which it should be decided whether the fixing of a minimum wage is desirable and practicable. When a decision has been reached as to whether the conditions in any case justify the setting up of machinery, particular attention should be given to the cost of enforcement, which may be prohibitive owing to the slow growth of the spirit of compliance with industrial law among employers, the ignorance and illiteracy of the workers, the possibility of collusion, etc. The policy of gradualness should not be lost sight of if the desired end is to be achieved without disaster.[1]

It is interesting that the Congress ministry in Bombay state in their Memorandum (August, 1937) on 'The Welfare of the Industrial Worker', that they are examining the possibility of devising measures for setting up minimum wage-fixing machinery to meet special requirements—their objective being the satisfaction of 'at least the minimum human needs' of the industrial worker. Accordingly the Bombay Textile Labour Enquiry Committee has been asked, among other matters, to make recommendations regarding the establishment of a minimum wage and the methods of automatic adjustment of wages in future.[2] So also the action taken by the Government of Bombay in instituting in 1934 a

[1] *L.C.R.*, 212-14.

[2] *Labour Gazette*, Bombay, August 1937, p. 922 and October 1937, p. 97.

comprehensive wage census in the Bombay Presidency is calculated to throw further light on the question of introducing minimum-wage-fixing machinery.

§28. **Indebtedness.**—The majority of the industrial workers remain in debt for the greater part of their working lives. It is estimated that in most industrial centres not less than two-thirds of the labouring population is in debt and that the amount of debt commonly exceeds three months' wages. A great majority of the workers are in debt to their food suppliers. Defaults are common owing to the improvidence and poverty of the labourer and are in fact encouraged by the money-lender, so that a small initial loan speedily accumulates into a permanent and intolerable burden. The most important single cause of indebtedness is the expenditure on festivals, especially marriages. In respect of borrowing, the position of the industrial worker is in several important ways different from that of the agriculturist. The mobility of the industrial worker from mill to mill, centre to centre, and town to village naturally makes the conditions of borrowing very much harder. Again, at least some part of the borrowing of the agriculturist is productive, being in the form of short-term loans repaid from the successful results of its application to land, while the loans to industrial labourers are generally unproductive. Lastly, unlike the agriculturist, the industrial worker is rarely in a position to offer adequate security. It is, therefore, easy to understand why the rates of interest tend to be exceptionally high in his case. Co-operation, on which much stress is laid in the case of the agriculturist, is difficult for the factory worker on account of his constant mobility. Moreover, credit in the sense of increased borrowing capacity is not the worker's need. Indeed he would benefit if his attractiveness as a field of investment were reduced and if it were made unprofitable to the money-lender to advance amounts which it is beyond the capacity of the workers to repay. The Labour Commission have made some proposals to secure this end. They propose that the salary and wages of all workmen receiving less than Rs. 300 a month should be exempted from attachment, as also workers' contributions to bona fide provident funds. The Government of India have accordingly amended the Civil Procedure code with a view to exempting salaries below a defined limit from attachment. It is also suggested that arrest and imprisonment should be abolished in the case of an ordinary industrial worker unless he is proved to be able and yet unwilling to pay[1] and that

[1] The Government of India have decided to undertake legislation on an experimental scale restricted to the province of Delhi in the first instance. *Indian Year Book* (1937-8), p. 521.

summary procedure should be instituted for the liquidation of workers' unsecured debts and the Courts empowered to adjust the amount of the decree to what the worker could pay without undue hardship.

LABOUR LEGISLATION IN INDIA

§29. **Growing scope of labour legislation in India.**—Labour legislation in India naturally does not occupy the same important position as in Western industrialized countries like England and the United States, owing to 'the deliberateness of the spread of mechanical power and narrowness of the area affected'. Much of the work is done out of doors or in sheds without walls, and the problems of overcrowding, bad ventilation and undesirable mixing together of the two sexes have not to be faced on the same scale. With the growing industrialization of the country, a better realization of the duties of the State towards labour, the awakening of the working classes in India to their rights in recent years and the acceptance by India of her obligations towards the International Labour Organization of the League of Nations, labour legislation is coming to occupy a more and more important position.[1] Determined State action for the purpose of minimizing the well-known evils of industrialism is necessary even if it means a certain slackening of the pace of industrialism. So far we have on the whole failed to profit by the experience of European countries. Without the excuse of ignorance we have allowed to appear in our midst certain familiar abuses, such as the rise of slum-cities, the exploitation of child-labour, excessively long hours of work for men and women, bad sanitation and absence of safety measures —abuses which we are now trying painfully to correct.

§30. **Beginnings of factory legislation in India.**—The question of factory legislation in India appears to have been first raised in the Report of Major Moore, Inspector-in-Chief of the Bombay Cotton Department in 1873. The progress made by the Bombay cotton mill industry aroused the jealousy of the Lancashire manufacturers, and in 1874 the Manchester Chamber of Commerce sent a deputation to the Secretary of State for India to urge the application of the British Factory Law to India. The result was the appointment of a Factory Commission by the Government of Bombay in 1875, of which the first Factory Act (1881) was the outcome. Its main provisions were as follows:

The employment of children below the age of seven was prohibited. Between that age and twelve, they were not to work for

[1] See §1.

more than nine hours a day. An hour's daily rest and four holidays in the month were prescribed for children. No relief, however, was given to women and adult male labour. The Act applied to factories employing not less than a hundred persons and using power. Local Governments were to appoint Inspectors of Factories.

Agitation to amend the first Factory Act began almost immediately after its passing. The 1881 Act was on the whole a triumph for conservative opinion, which prevented its provisions from being more stringent as desired by the Government of India and the Bombay Government. Again pressure from Lancashire resulted in the Secretary of State moving in favour of the expeditious adoption of more rigorous legislation, and the second Factory Act of 1891 was passed. Its provisions applied to all establishments using power and employing not less than fifty persons. But the Local Governments were to have power to extend it to others employing not less than twenty persons. The lower and upper age-limits for children were raised to nine and fourteen respectively. Their hours of work were limited to seven in any one day and had to be between the hours of 5 a.m. and 8 p.m. Restrictions were placed on the employment of women. They were not to work in factories before 5 a.m. and after 8 p.m., except in places where an approved system of shifts existed. Their hours of work were limited to eleven in one day entitling them to a total rest of one and a half hours. Men workers were to enjoy an interval of half an hour's rest between 12 noon and 2 p.m. and a weekly day of rest. There were also certain provisions which secured better ventilation and cleanliness and aimed at preventing overcrowding in factories.

§31. **Factory Act of 1911.**—Excessive hours of work in Bombay mills, made possible by the increasing use of electric lights, and also in some Calcutta jute mills, the usual agitation on the part of Lancashire manufacturers, the agitation by the press in India and the lead given by some employers of labour led to the appointment of a commission which reported in 1908.[1] This was followed by the passing of the Factory Act of 1911 which brought within its scope seasonal factories working for less than four months in the year. It made the possession of an age certificate compulsory. The hours of work for children in textile factories were reduced to six per day. The Act restricted the employment of women by night, allowing it only in the case of cotton ginning and pressing factories. For the first time the hours of adult male workers were

[1] A. G. Clow, *Indian Factory Legislation*, pp. 39-45.

restricted by law, the limit being twelve hours per day in the case of textile factories alone, as recommended by Dr Nair, who was the only member of the Factory Commission of 1908 to plead for the direct limitation of hours for adults. Furthermore, in all textile factories, except those working with an approved system of shifts, no person was to be employed before 5 a.m. or after 7 p.m.—the new limits laid down generally for the employment of women and children. Lastly, more extensive provisions relating to health and safety were introduced and factory inspection was made more effective.

§32. **Factories Act of 1922.**—The Great War had important effects on factory administration and ultimately on the Factory Act. There was a considerable extension of industrial activity in India and the number of factories and of persons employed rose by about twenty-five per cent between 1914 and 1919. Factories had to be exempted from many provisions of the Factory Act and there was a fall in the average number of inspections. But the most important effect was produced on the workers. The increased demand for labour strengthened their position, while the rising prices and profits and the general unrest which followed the War led to increased consciousness of power and a strong disinclination to accept disagreeable conditions. Thus for the first time in India the desire of the operatives became a potent force in securing improved conditions and more drastic legislation.

The acceptance by India of her obligations, arising from the connexions adopted by the International Labour Conference at Washington in 1919, necessitated further changes in factory legislation. By the Factories Act of 1922, all power-using factories employing not less than twenty persons become subject to factory legislation. Option was given to the Local Governments to extend it to factories employing not less than ten persons whether power was used or not. The minimum age of employment for children was raised to twelve and the upper limit to fifteen. Children between these ages were not to work for more than six hours a day in any factory. Children and women were not to be employed in any factory before 5.30 a.m. and after 7 p.m. The hours of work for adults were limited to sixty in a week and eleven in any day, a week consisting of not more than six days. Liberal rest intervals were also secured to all classes of workers. The Act provided for a rest period of an hour after every six hours, though this might be split up into two half-hours at the request of the employees, provided not more than five hours' continuous work was done. The system of inspection was further improved by the appointment of more whole-time inspectors with good technical qualifications, in

the principal industrial centres. Lastly, provisions regarding safety and health were further extended, the Local Governments being given power to fix standards of ventilation and artificial humidification.

§33. **Factories Act of 1934.**—The Factories Act of 1922 was amended in 1923, 1926 and 1931. Certain administrative difficulties were thus removed and a few improvements of a minor character were introduced. A new consolidating Act was passed in 1934 on the recommendations of the Labour Commission and brought into force from 1 January 1935. This Act

(i) Draws a distinction between seasonal and perennial factories.

(ii) Introduces a third group of adolescents (over fifteen and under seventeen years of age to be deemed as children if not certified as fit for adult employment).

(iii) The existing maximum limits of eleven hours per day and sixty hours per week continue to apply in the case of seasonal factories but are reduced to ten and fifty-four respectively in the case of perennial factories subject to certain exceptions. For children the maximum hours everywhere are five per day.

(iv) The principle of 'spreadover' is introduced for the first time, that is the period of the number of *consecutive* hours of work is limited to thirteen in the case of adults and seven and a half in the case of children.

(v) The existing provisions with regard to control of artificial humidification are expanded. The Act also gives power to Local Governments to authorize an inspector to call upon managers of factories to carry out specific measures for increasing the cooling power of the air where necessary.

(vi) Certain provisions are made with regard to welfare, such as adequate shelters for rest in factories, rooms reserved for the use of children of female workers, first aid appliances, etc.

(vii) Power is given to Local Governments to make rules prescribing fitness and preventing the employment of children not certified as fit.

(viii) Inspectors are authorized to require managers to remedy any inadequacy or defect in the construction of a factory likely to be dangerous to workers.

(ix) Limits are imposed on the amount of overtime that can be worked and payment for overtime is regulated.

§34. **Labour legislation for mines.**—Labour regulation was much tardier in coming in the case of the mining industries than in that of the textiles. In 1901, the first Indian Mines Act was passed and inspectors were appointed. In view of the recommendations of the Washington Conference and the large numbers employed in

the rapidly developing mining industry, revised legislation was passed in 1923. It enlarged the definition of a mine, limited the hours of work to sixty per week for workers above ground, and fifty-four for workers underground. A week was not to consist of more than six days. No child was allowed to work below ground and a child was defined as a person under the age of thirteen years. No restriction was placed on the employment of women underground in spite of Mr N. M. Joshi's plea for prohibition of such work. In view of the fact that forty-five per cent of the labour employed below ground was composed of women, it is clear that sudden and absolute prohibition would have caused serious dislocation in one of the basic industries of the country. On the other hand, the need for reform was equally clear. In exercise of the power given by the Act of 1901 and renewed in 1923, the Government of India framed during 1929 regulations whose effect was to exclude women from underground workings forthwith, except in exempted mines, that is except in coal-mines in Bengal, Bihar and Orissa and the Central Provinces, and salt-mines in the Punjab. In these exempted mines exclusion is to be gradual, so that after 1 July 1939 women will be entirely excluded from underground workings.[1]

The Indian Mines Act of 1923 did not place any statutory restrictions on the daily hours of work. In March 1928, therefore, the Legislature passed an amending Act under which no mine was allowed to work for more than twelve hours out of twenty-four through the same set of workmen. It allowed the adoption of a system of shifts of twelve hours from a batch of workmen if continuous work for all the twenty-four hours were desired. Owners were required to put up notices outside the offices stating the hours of work and shifts of workmen. The following are some of the changes introduced by the Amending Act of 1935, which is based on the recommendations of the Royal Commission on Labour; and is influenced by the Draft Convention adopted by the 15th session of the International Labour Conference.

No person is allowed in a mine on more than six days in any one week. A person employed above ground in a mine is not allowed to work for more than fifty-four hours in any week or for more than ten hours in any day. The periods of work of any such person are so arranged that along with his intervals

[1] In 1935 the total number of all mines which came under the Indian Mines Act was 1,813. The number of persons employed was 253,970 (189,263 below ground and 64,707 above ground). In the same year the number of females employed underground was 9,551 as compared with 24,089 in 1929 and 31,889 in 1926.

for rest; they are not in any day to spread over more than twelve hours, and that he is not to work for more than six hours before he has had an interval for rest of at least one hour. A person employed below ground in a mine is not allowed to work for more than nine hours in any day. Work of the same kind is not to be carried on below ground in any mine for a period spreading over more than nine hours in any day except by a system of relays so arranged that the periods of work for each relay are not spread over more than nine hours. The employment of children under fifteen years of age in any mine is prohibited.

In addition to the Mines Acts, conditions of employment in mines are regulated also by the appointment of Mines Boards of Health which look after the health of the labour force. One such Board, for example, was established in 1919 for the coal-fields in Bihar and Orissa, the necessary funds being obtained from royalties from collieries. A Board is empowered to compel the owners of mines within the mining settlement area to provide housing, water-supply, sanitary facilities and medical help.

§35. **Labour legislation for railways.**—All railways workshops come under the administration of the Factories Act of 1922. The Indian railways employ nearly a quarter of a million workers in other occupations for which, until recently, no provisions regarding control of hours of work, etc. were made, in spite of the ratification by the Government of India of the Washington (1919) and Geneva (1921) Conventions in their application to railways in British India. The problem was beset with many difficulties which were overcome by the Indian Railway (Amendment) Act of 1930 which gave effect to the Government's statutory obligations under the International Labour Conventions. A railway servant must not be employed for more than sixty hours a week on the average in any month. A railway servant whose employment is essentially intermittent cannot be employed for more than eighty-four hours in any week. Temporary exemptions of railway servants from the above provisions may be made (i) in case of emergency involving serious interference with the ordinary working of the railway and (ii) in cases of exceptional pressure of work, overtime being paid only in the latter class of cases. A weekly rest of a full twenty-four hours is prescribed, subject to temporary exemptions as above. Compensatory periods of rest for the period forgone must be granted. The Governor-General-in-Council may appoint persons to be Supervisors of Railway Labour to inspect railways in order to determine if the provisions of the Act are duly observed.

§36. **Workmen's Compensation Act of 1923 (as amended up to 1933).**—The right of the worker to be insured at the expense

of the industry for all accidents in the course of the worker's regular employment and as a result of the risks taken in that employment, has received legal recognition in most Western countries. The progress of the idea of compensation for accidents has been slow in India. As far back as 1884, workers in Bombay made a demand for the introduction of compensation. Although a certain number of enlightened employers instituted a system of compensation for their work-people, the practice was by no means generally adopted. Prior to the Act of 1923, an employer could be sued under the Fatal Accidents Act of 1885 in case of death arising from an accident. But this Act was seldom invoked. Further, with regard to the general question of employer's liability the position in India was vague.

The principle of the Act of 1923 was that compensation should ordinarily be given to workmen who had sustained injuries by accidents arising out of and in the course of employment, compensation being also given in certain circumstances for diseases. Although the measure followed in general principles the legislation in force elsewhere, it also struck a certain distinctive note and was adapted to meet the peculiarities of industrial life in India. The scope of the Act, which was originally limited, was considerably widened by amending Acts passed in 1926, 1929, 1931 and 1933. This was made necessary partly by the ratification by the Government of India of the draft convention regarding workmen's compensation for occupational diseases adopted by the Seventh International Labour Conference (1925) and partly by the recommendations made by the Royal Commission on Labour in 1931. The Act of 1923 was an experimental measure and has now been replaced by the amending Act of 1933.

The Act of 1933 covers railways; tramways; factories; mines; seamen; docks; persons employed in the construction, demolition or repairs to certain buildings; or of roads, bridges, tunnels; marine works; operations relating to telegraph, telephone, or overhead electric lines; blasting operations or excavations, boat services; lighthouses; tea, coffee, rubber or cinchona plantations; electricity or gas generating stations, cinematograph workers, salaried motor drivers, and underground sewage workers. In all cases persons employed in an administrative or clerical capacity and those whose monthly earnings exceed Rs. 300 are excluded. The Act covers over seven million industrial workers in the country.

The amount of compensation payable depends on the average monthly earnings of an injured or deceased workman. The amounts of compensation payable in the case of an injured workman whose monthly wages are not more than Rs. 10 are Rs. 500 for death;

Rs. 700 for permanent total, and half the monthly wages for temporary, disablement. For a workman whose monthly wages are between Rs. 50 and Rs. 60, the corresponding figures are Rs. 1,800, Rs. 2,520 and Rs. 15 respectively. The maxima for persons earning over Rs. 200 per month are Rs. 4,000, Rs. 5,600 and Rs. 30 per month respectively. In the case of minors the amounts of compensation for death and for permanent total disablement are at a uniform rate of Rs. 200 and Rs. 1,200 respectively, and half the monthly wage for temporary disablement. No compensation is payable in respect of a waiting period of seven days following that on which the injury was caused.[1]

The dependants to whom the amount of compensation is payable are firstly those who are actually dependants such as a wife or a minor child; and secondly those who may or may not be in that position such as a husband, a parent other than a widowed mother, etc. Provision is made for enabling the interests of dependants in cases of fatal accidents to be better safeguarded, by ensuring that such accidents should be brought to the notice of Commissioners, appointed under the Act by Provincial Governments.

The general administration of the Act and the settlement of disputes thereunder are entrusted to these commissioners, who have been given wide powers. The procedure is simple and opportunities for appeals restricted. For the success of a measure like this rapid inquiry made by medical men capable of forming estimates of the injuries received along with the enlistment by the State of impartial judges to see that the worker gets the benefit that is due to him are necessary. The migratory habits of the industrial worker, his ignorance of the financial relief to which he is entitled under the Act, lack of qualified men properly to put up the workmen's case for compensation are some of the factors which render the operation of a measure of this kind difficult in India.

§37. **Social insurance.**—The principle of social insurance for the protection of the industrial worker against the hardships arising from sickness, unemployment and old age has long been recognized in industrial countries like the United Kingdom and Germany. International Labour organizations have also lent their support to social insurance by adopting from time to time conventions regarding all these matters. Some of these questions have been receiving the attention of the Government of India and other parties concerned, particularly since the Tenth International Labour Conference (1927) adopted a convention in respect of sicknesss insurance of industrial

[1] *Indian Year Book*, 1937-8, p. 532.

and agricultural and domestic workers. Pointed attention has been drawn to these problems in India since the publication in August 1937 of the programme of the Congress Ministry in Bombay, regarding the welfare of the industrial worker. They visualize the development of a comprehensive system of social insurance and have under consideration the feasibility of legislation for the grant of leave with pay during periods of sickness, in the hope that it will pave the way for sickness insurance.[1]

There are considerable difficulties, administrative, financial and otherwise, in the way of the introduction and enforcement of social insurance in India. The requisite statistical and actuarial basis for the various forms of social insurance are totally lacking at present. As regards agricultural labour, it is casual in nature and there is absence of qualified medical men in the districts. So far as the industrial worker in the Bombay Presidency is concerned the Government of Bombay have already set in motion the machinery of the Labour Department for the collection of material which within a reasonable distance of time should enable the Government to decide what can be done to frame sound and workable schemes conforming to Indian conditions. While this move is welcome it is necessary to bear in mind two considerations. In the first place, the capacity of industry at this juncture to bear additional burdens thus imposed on it must be duly considered; and in the second place, the social insurance schemes must be based on a contributory basis as in other countries, the employers, the workers and the State, all bearing their fair share of the burden. It is also desirable that such action as is taken in these matters should be on an all-India basis, lest industries in one province should be penalized while those in other provinces or Indian States escape.

§38. **History of industrial disputes in India.**—There were a few strikes in this country in the eighties of the last century, but on the whole, before 1917, they were rare phenomena. It was only in the opening years of the present century that the value of the strike as a weapon received general recognition from workers. Thus in 1905 there were several strikes in Bombay owing to the introduction of electricity and excessively long hours of work. It was, however, during the War that the strike came to be regarded as an ordinary weapon of industrial warfare. The economic upheaval and the general feeling of unrest created by the War, the increase in the cost of living due to rise in prices, and the spread of class consciousness have produced a large crop of strikes since 1917. The position became specially acute in 1919-20, when a

[1] *Labour Gazette* (Bombay), August 1937, p. 923.

great strike occurred in Bombay involving 150,000 cotton mill workmen. Among the contributory causes of these strikes have been long hours of work; bad housing; lack of provision, till recently, for compensation for injuries received; the ill-treatment of the workers by foremen; the sympathy of one group of strikers for others, and so on. We shall notice in a later section how the trade union movement originated during this period.

§39. **Frequency of industrial disputes.**—During the period 1920-35 the number of industrial disputes every year has varied from 118 in 1932 to 396 in 1921. The largest number of disputes have been in cotton and woollen mills and for that reason in the Bombay Presidency. In Bombay city itself the influence of communistic ideas has latterly been a powerful factor making for the growth of labour unrest.

The strike situation was very serious in 1919-21 owing to the economic distress and high prices induced by the War. With the gradual restoration of normal conditions and a fall in the cost of living, the strike fever appeared for some time to be subsiding. The increased wages granted during the War remained as they were for some time after it, in spite of a fall in prices, thus securing some increase in the real wages of labour. The trade depression which followed, however, led to a movement on the part of employers of labour to stop paying War bonuses or to decrease wages, causing a fresh outburst of strikes at industrial centres like Bombay and Ahmedabad. The years 1926 and 1927 were comparatively quiet. The year 1928, however, saw a recrudescence of industrial unrest, and the outbreak of several big strikes all over the country, e.g. the big strike in Bombay cotton mills in October 1928, following an attempt on the part of the millowners to introduce rationalization and new methods of work. The intensification of these strikes as well as the unusually prolonged duration of some of them was attributed to Russian communistic influences and the secret help derived from the same quarter. The Public Safety Bill, thrown out by the Assembly in September 1928 and disallowed later by the President, was justified by the Government as a necessary measure for nipping in the bud these unwholesome influences. By an agreement reached between the millowners and the Strike Committee, it was decided to refer the outstanding differences to a Committee of Inquiry consisting of three members appointed by the Government of Bombay (the Fawcett Committee). This committee reported in March 1929 but its labours did not appear to bring about peace in the textile industry. A prolonged strike in the Iron and Steel Works at Jamshedpur and strikes on several railways, threatened or actual, and accompanied, in the case

of the E.I.R. and S.I.R. strikes, by considerable violence, were a feature of the year 1928.

The most important industrial dispute during 1929 occurred in the Bombay textile mills in connexion with the dismissal of 6,000 men of the Wadia group of mills. A court of inquiry under the chairmanship of Mr Justice Pearson of the Calcutta High Court was set up on 3 July 1929, under the Trade Disputes Act passed earlier in the year. Its report laid the whole blame on the Girni Kamgar Union for the protraction of the dispute due to its uncompromising attitude over the Fawcett Committee's recommendations. The court strongly recommended not only the enforcement of the Mediation Rules recommended by the Fawcett Committee, providing for a conciliation machinery representing both parties to secure the consideration and settlement of trade disputes in their early stages,[1] but also the constitution of a joint tribunal of arbitration to which a dispute could be referred after a strike. It was also necessary to introduce a scheme of unemployment insurance to deal with the situation caused by the introduction of the 'efficiency scheme'. The Court of Inquiry pointed out that the Board of Conciliation contemplated by the Trade Disputes Act 1929 could achieve little unless supported by the goodwill of the parties concerned (*Report*, par. 87). The depression in trade, particularly in textiles, was at its worst in the year 1933. Mills attempted wage-cuts as a necessary measure of economy. This led to a certain number of strikes which, however, the labourers were unable to continue beyond a short period. In 1934 a Labour Committee was formed on an all-India basis to organize a universal strike in cotton mills all over the country. The Committee succeeded in bringing about a strike in all the textile mills at Sholapur for over three months and in more than half of the Bombay mills for over two months. The Bombay Government caused a Departmental Inquiry into the question of wage cuts in the Presidency. The report of this inquiry was published in June 1934 and the strike in the Bombay mills was called off almost simultaneously. The most important result of this inquiry was the passing by the Government of Bombay of a Trade Disputes Conciliation Act which is reviewed in §41 below. For a period of nearly three years after the passing of the Act there was little industrial strife in the cotton mill industry in the Bombay city. In recent months, there has been a recrudescence of labour troubles in Bombay, Ahmedabad, Cawnpore, Madras and other industrial centres in India caused partly by the demand for higher wages and restoration of wage cuts on the

[1] See *Report of the Fawcett Committee*, Appendix XI.

ground of industrial and business recovery, and partly by the communist activity in labour circles. There are at present (April 1938) three Labour Enquiry Committees at work, at Bombay, Nagpur and Cawnpore.

§40. **Prevention of industrial disputes.**—Before dealing with the machinery for the settlement of industrial disputes *after* they have broken out, a few words might be said regarding the methods of preventing them. The first essential is the creation of sound organizations both of employers and employees. The employers are for the most part sufficiently well organized in India, but not so the workers. The formation of sound trade unions of the workers is the first step in the evolution of any means, preventive as well as curative, of strikes and lock-outs. Efficient organizations on either side, competent to speak for their respective sides, will tend to prevent the occurrence of sporadic strikes and lock-outs and the formulation of grievances after rather than before going on strike—features which are peculiar characteristics of strikes in India at the present moment. A permanent Arbitration Board, with Mr M. K. Gandhi as one of its most prominent members, has been established for the settlement of disputes in the textile industry in Ahmedabad. The Bombay Industrial Disputes Committee of 1922 recommended the formation of Works Committees or Shop Committees on the lines of the Whitley Committees in England. On these committees the workers would be represented along with the employers and would be responsible for the fixing and observance of conditions under which work is to be carried on. Such committees possess the advantage of discounting the absence of personal relationships between the operatives and the employers, and have further an educative value for the operatives themselves. It may be mentioned that such committees have already been established by some enlightened employers like Tatas, and by the Government in their capacity as employers. The Labour Commission also recommend the formation of Works Committees which, they think, are capable of playing a useful part in the Indian industrial system (*L.C.R.*, 342-3).

We may now proceed to discuss the arbitration and conciliation methods for settling industrial disputes. The numerous disputes during the post-War years clearly showed the necessity of suitable machinery for investigating and settling them. The Government of Madras were the first to take steps in this direction by setting up courts of inquiry to deal with individual disputes as they arose. The Committees appointed by the Bengal Government (1921) and the Bombay Government (1922) did valuable spade work and made a number of detailed recommendations regarding the machinery to

be set up for preventing and settling disputes. The Government of India held that the subject was one for all-India legislation. This, however, was held to be premature until the Trade Union Bill had been passed. The Trade Union Bill became law in 1926 and came into force the next year. The Trade Disputes Act was not passed till 12 April 1929 and was brought into force with effect from 8 May 1929. It was to remain in force for a period of five years only in the first instance but by an amending Act it was made permanent in 1934.

§41. **Trade disputes legislation.**—(i) *The Trade Disputes Act of 1929.*—The Act closely follows the English legislation on the subject and does not provide for *compulsory* arbitration. As in England, public opinion is regarded as the decisive factor in settling disputes and the underlying idea is to help the clear framing and discussion of the issues by an impartial tribunal, so that a well-informed public opinion may be formed. The Act provides for the setting up of Courts of Inquiry and Conciliation Boards.

(*a*) *Nature of inquiry.*—The Provincial Government or the Governor-General-in-Council, where the employer is the head of a department under the Governor-General-in-Council or a railway company, is authorized to appoint, for prevention or settlement of a dispute, a Court of Inquiry or Board of Conciliation, as the case may be, where both parties to the dispute apply, whether separately or conjointly, provided the persons applying represent the majority of each party.[1] (*b*) *Constitution of the Court of Inquiry.*—The Court of Inquiry is to consist of an independent chairman and such other independent persons as the appointing authority may think fit, or it may consist of one independent person. (*c*) *Board of Conciliation.*—The Board of Conciliation will have a different constitution and will consist of a chairman and two or four other members as the appointing authority thinks fit, or it may consist of one independent person. The chairman is to be an independent person and the other members shall be either independent persons, or persons appointed in equal numbers to represent the parties to the dispute on the recommendations of the parties concerned. (*d*) *Procedure.*—The duty of such a Board is to endeavour to bring about a settlement after investigation of the merits of the dispute and to do all such things as it may think fit to induce the parties to come to a fair and amicable settlement and give them reasonable time for doing so. In case of failure to bring about a settlement, the Board is to send a full report to the appointing authority setting forth the

[1] The Labour Commission recommend that the possibility of establishing permanent courts in place of *ad hoc* tribunals under the Act should be examined (*L.C.R.*, 346).

proceedings and the steps taken by the Board for the settlement of the dispute together with its findings and recommendations. The appointing authority is to publish the report, final or interim, as soon after its receipt as possible. (*e*) *Strikes in public utility services.*—The provisions in the second part of the Act regarding public utility services are among the most important in the whole Act. A public utility service means (1) any railway service so declared for the purposes of the Act by the Governor-General-in-Council; (2) any postal, telegraph or telephone service; (3) any business or undertaking which supplies light or water to the public; and (4) any system of public conservancy or sanitation. Special penalties are laid down for employees, employed on monthly wages, in such services in the event of their going on strike in breach of contract without having given to their employer, within one month before so striking, not less than fourteen days' previous notice. Employers carrying on such public utility services are made liable to be punished (the fine being heavier) for locking-out their employees without a similar notice. Abettors of an offence, as defined above, are left to be dealt with under the ordinary Criminal Amendment Law. (*f*) *Illegal strikes.*—There are also special provisions in respect of illegal strikes on the lines of the British Trade Disputes Act of 1927. A strike or lock-out is to be regarded as illegal which (1) has any object apart from the furtherance of a trade dispute within the trade or industry in which the parties to the disputes are engaged; and (2) is designed or calculated to inflict severe, general and prolonged hardship upon the community, and thereby to compel the Government to take or abstain from taking any particular course of action. Any sums collected or applied in direct support of such strikes are illegal. Sympathetic strikes are declared illegal by defining a trade dispute within an industry as one which is between the employers and the employees of that industry with regard to the employment in that industry alone. The trade union privileges of members are protected from being invaded on the ground of a refusal to join such illegal strikes.

The Act presupposes organization on the part of the employers and the employees, and, as already suggested, is intended to promote such organization to check sporadic strikes and arbitrary lock-outs and to help the formulation of grievances before and not after a strike is declared. An important omission in the Act is the absence of any provision to prevent intimidation. Picketing is not mentioned in the Act, because all picketing is not objectionable and it is punishable under the ordinary law when it becomes intimidation. Sympathetic strikes are by implication illegal under the Act.

This has been criticized by labour leaders as giving the Government the power to declare any big strike illegal, but on the other hand, a general strike like the triple strike in England may be a real menace to the community. Like many other provisions of law, therefore, this particular provision cannot be demurred to merely because it is liable to be abused. A more valid criticism would be to point out that, since the strikes that have occurred in India so far bear no parallel to the big general strike in Great Britain, there is no particular necessity, under the present circumstances, for such a provision. It has also been argued that the clauses regarding illegal strikes interfere with the fundamental human rights of the workmen and further that they will tend to choke the trade union movement in India, which is still in its infancy, and will create distrust in the mind of the workers. The view is held by some critics that the portions of the Act dealing with strikes in public utility services and illegal strikes were unnecessary. Sudden strikes in social security services, such as the supply of water, light and sanitation, are already illegal and punishable under the Penal Code. Strikes in ordinary public utility services (as distinguished from security services) such as postal, telegraph or telephone service, or even railway service, however, need not be dealt with severely.[1]

(ii) The Labour Commission recommended that every Provincial Government should have an officer or officers to undertake conciliation. The Commissioner of Labour in Madras, the Director of Industries in the Punjab, the Director of Statistics, and the Labour Commissioner in Burma, and Deputy Commissioners and the Director of Industries in the Central Provinces have accordingly been given powers as conciliation officers.

Bombay has passed the Trade Disputes Conciliation Act (1934) providing for the appointment of the Commissioner of Labour as ex-officio chief conciliator and also for the appointment of a Labour Officer, special conciliators and assistant conciliators. On receipt of a report or an application from the Labour Officer or any of the parties to a dispute in the textile industry in Bombay, or acting upon their own knowledge and information, the conciliation

[1] A Bill to amend and widen the scope of the Trade Disputes Act (1929) has recently (April 1938) been passed by the Central Legislature. It alters the definition of an illegal strike; includes within the list of utility services any inland steam vessel and tramway service which Government may notify and any undertaking which supplies power to the public; and provides for the appointment of conciliation officers with certain powers by those Provincial Governments which desire to appoint them.

officers are empowered to summon the parties before them with a view to conciliation. A Labour Officer was appointed in September 1934 to guard the interests of the workers. The Millowners' Association has also appointed a Labour Officer of its own to represent mill managements in proceedings with the Government Labour Officer and the chief conciliator. It was claimed for this Act that it had succeeded in practically eliminating industrial strife in textile mills in Bombay city. After three years of comparative industrial peace, however, there has been since the middle of 1937, as previously stated, a recrudescence of labour trouble in Bombay as also in other textile centres. The Government of Bombay have recently (March 1938) circulated the draft of a Bill intended to prevent strikes and lock-outs and to promote the amicable settlement of disputes in factories and other industrial establishments. It is based on the principle of compulsory conciliation, whereas the Central Act makes conciliation voluntary.

§42. **Trade union movement in India.**—Already in 1918 trade unions were organized in Madras under the leadership of Mr B. P. Wadia. From Madras the trade union movement spread to Bombay. The industrial unrest, which may be said to have commenced in 1917, resulted in the creation of a number of labour organizations. These were, however, temporary in character and dissolved into thin air as soon as their immediate object, whether it was increase of wages or any other thing, was fulfilled. They were ' little more than strike committees consisting of a few officers and perhaps a few paying members'.[1] This situation, has, however, been gradually improving and the remarkable growth in the number of trade unions, especially in 1921, shows that the movement has come to stay. It experienced a slight set-back in the year 1923 owing to an improvement in the economic condition of the workers and the consequent diminution in the number of strikes. In the initial stages of the movement the presence of actual economic distress was practically the only bond among the workers, which tended to weaken when conditions were more favourable. Latterly the movement has shown distinct signs of recovery and may be further expected to gain in strength owing to the protective influence of the Trade Union Act of 1926. Moreover, the trade union movement in India has almost from its inception had the advantage of an all-India organization like the All-India Trade Union Congress which has been holding annual sessions since 1920.[2] The creation

[1] See Hurst, op. cit., p. 101.

[2] In 1929, there occurred a serious split in the ranks of the Trade Union Congress and there came into existence three distinct groups, viz. the communist

of the International Labour Office hastened the establishment of a central trade union organization in India. The presence of its representatives at the annual Labour Conferences at Geneva has brought the Indian movement into direct touch with the movement in the Western world.

The All-India Trade Union Congress claimed in December 1929 that it represented organized workers numbering 189,436.[1] The total number of registered trade unions under the Trade Union Act of 1926 (see below) was 213 in 1934-5. During the same year the 183 unions furnishing returns accounted for 284,918 members and had a total income of Rs. 5·29 lakhs. The percentage of female workers was very small, being less than 2 per cent of the total membership. Not all these unions, however, are equal in strength and vitality. About half of them are organizations either of Government servants or of persons connected with Government employment. Trade unionism has met with comparatively greater success among railway and postal employees, but on the whole it is weak in the great organized textile and mining industries. The Ahmedabad Textile Labour Union is, however, the biggest and best organized trade union in India.

§43. **Difficulties of the movement in India.**—The special difficulty of the trade union movement is, in the first place, the floating character of the labour population (see §3). In the second place, the labour force in industrial centres like Bombay and Calcutta is a heterogeneous mass of men speaking a variety of languages and, therefore, not feeling intimately drawn to each other. Where, however, the proportion of emigrant labour is small, as in Ahmedabad, the trade unions are much stronger than elsewhere. Thirdly, many labourers dislike the idea of regular contributions and union discipline, and this accounts for the small

group, the liberal group and the rest. In 1935 a Joint Committee of the two principal organizations, viz. the All-India Trade Union Congress and the National Trades Union Federation (1933) was formed with a view to promoting unity, which has only recently been achieved, owing to fundamental differences in outlook and methods. It is a happy augury for Indian labour that the unification of the Indian Trade Union movement was effected at the joint session of the two bodies in April 1938. There are a number of other all-India associations like the All-India Postal and R.M.S. Association, the National Federation of Textile Labour in India, etc.

[1] Messrs Purcell and Hallsworth, British Trade Union Delegates to India, calculated that there were in all 25,266,109 persons in the organizable groups of workers (including 21,676,107 agricultural field and farm labourers, but excluding domestic servants and Postal and Government office employees) in the various industries in India. See *Report on Labour Conditions in India* (British Trade Union Congress Delegation 1928), p. 15.

percentage of men enrolled in any establishment. Even a small contribution is again felt as a burden owing to the great poverty of the average worker. Fourthly, the majority of the workers are illiterate and are, therefore, unable to find leaders from their own ranks. This accounts for a special feature of the trade union movement in India, namely that it has been largely led by men from the middle classes, professional lawyers and others who have not in all cases distinguished between political and economic considerations. Moreover, their interests are divided amongst many unions and their knowledge of technicalities is very slight. Another handicap is the absence of a true democratic ideal, which is so essential for effective trade unionism. All this stands in marked contrast with the position which trade unions hold in England where they are officered exclusively by the workers themselves. While it is, however, easy to decry the interference of politicians and lawyers in the labour movement in India, we must recognize the value of the pioneer work of the educated middle-class leaders in this connexion.[1] Lastly, successful trade unionism depends on at least a temporary acceptance of the existing social order with a view to gaining as much for labour as possible.[2] If working-class leaders are frankly out to destroy the present capitalistic order of society their influence must weaken the trade union movement. According to many competent observers this points to one of the principal reasons of the weakness of the movement in Bombay as contrasted with the striking success it has achieved in a centre like Ahmedabad. The representation given to labour in the Provincial Legislative Assemblies under the Government of India Act (1935) through special constituencies comprising registered Trade Unions is, however, expected not only to promote registration of new unions, but also to ensure maintenance of proper books of account and registers of members.

§44. **Trade Union Act of 1926.**—A decision of the Madras High Court at the end of 1920, giving an injunction restraining trade union officials or organizers from influencing labourers to break their contracts with their employers by striking to obtain increased wages, revealed the necessity of legislation for the registration and protection of Indian trade unions. Mr Joshi, the Labour Member,

[1] 'As in the early days of British trade unionism, when it had to rely largely upon men like Robert Owen, Francis Place, and later, Kingsley, Ludlow and Frederic Harrison, so too the Indian movement in its corresponding stage is almost wholly dependent upon the lawyer or "pleader" class for its union presidents and secretaries.'—***Report on Labour Conditions in India*** (British Trade Union Congress Delegation 1928). For some interesting comments on this subject see *L.C.R.*, 324-5, 328-9.

[2] Ahmad Mukhtar, *Trade Unionism and Labour Disputes in India.*

first brought the question before the Assembly in March 1921 and his persistent efforts in this connexion finally bore fruit when the Trade Union Act passed in 1926 came into force on 15 June 1927. The Act defines the legal position of Indian trade unions in definite and precise terms. The registration of trade unions is optional, but the Act confers certain valuable privileges on the registered bodies denied to those that choose to remain unregistered. The registered trade union is required to define its name and the objects for which it is established. It must keep a list of its members and provide for a regular annual audit of its funds which must be spent on certain specified objects calculated to promote the obvious interests of the members. Not less than one-half of the office-bearers of a registered trade union must be persons employed in the industry concerned. As against these restrictions, the Act grants immunity from criminal liability to all trade union officials acting in furtherance of all legitimate objects of the union. Nor are they liable to be indicted for conspiracy. The Act provides that (i) no suit shall be maintainable in any civil court against any officer or member of a registered union in respect of any act done by him in contemplation or furtherance of a trade dispute on the ground only that such act induces some other persons to break a contract of employment or is an interference with the trade, business, or employment of some other person or his right to dispose of his capital or labour as he wills; and that (ii) no suit shall be maintainable in any civil court against a registered trade union in respect of any act done in contemplation or furtherance of a trade dispute by any person acting on behalf of a trade union, provided it is proved that such person acted without the knowledge of or contrary to express instructions given by the executive of the trade union. A registered trade union may create a fund for the promotion of the civil and political interests of its members, the contributions however being on a strictly voluntary basis.

INDUSTRIAL WELFARE [1]

§45. **Nature of welfare work.**—Welfare work has been variously defined. One definition confines it to the voluntary efforts on the part of employers to provide the best conditions of employment in their own factories. A definition more generally accepted includes within the scope of welfare work 'all efforts which have for their object the improvement of the health, safety and general well-being and the industrial efficiency of the worker'.[2]

[1] On this subject read *L.C.R.*, ch. xiv.

[2] Presidential Address, All-India Industrial Welfare Conference, 1922.

These efforts may be made by employers of labour, or the State, or the employees themselves, or by social agencies. From one point of view, these activities may be regarded as humanistic, aiming at the welfare of the industrial population. From the narrower and purely utilitarian point of view, so-called 'welfare work' may be regarded as 'efficiency work' having a direct favourable reaction on the physical contentment and efficiency of the operatives and thus helping to counteract the migratory tendencies of Indian labour. Welfare work may also be considered as a means of developing a sense of responsibility and dignity amongst an illiterate class of workers, making them good citizens.

§46. **Divisions of welfare work.**—Welfare work falls into two broad classes: (i) activities inside the factory, or intra-mural welfare work, and (ii) activities outside the factory or extra-mural work. As regards intra-mural work for improving conditions of work inside the factory, an account of what has already been done by the State and, to a smaller extent, by employers, has been given earlier in the chapter.

In the past, welfare work, especially in regard to the proper utilization of leisure time, has received little attention at the hands of employers of labour, and such efforts as have been made have mostly taken the form of providing medical aid, minor educational facilities and housing. It is, however, receiving increasing attention at the present time, owing to the serious growth of industrial unrest. The Social Service League of Bombay was able, in 1918, to induce two enlightened mill agents to entrust to it the organization and management of two workmen's institutes for the benefit of operatives working in mills under the agencies of Currimbhoy Ebrahim & Sons and Tata & Sons. In 1922 an All-India Industrial Welfare Conference was held in Bombay. It discussed several interesting problems connected with welfare work and was able to effect some co-ordination of work carried on by various agencies at the different centres. The All-India Trade Union Congress has also been directing its attention to welfare work for some time past. In May 1926 the Government of India asked all the Provincial Governments to collect full information with regard to the steps taken and efforts made to ameliorate the conditions under which the workers live when not actually employed. This inquiry was undertaken in response to a recommendation adopted by the Sixth Session of the International Labour Conference requesting the various Governments concerned to supply the International Labour Office with up-to-date information regarding the use of the worker's spare time.

Besides the interest shown by some of the more enlightened employers in Bombay,[1] several employers of labour at the other industrial centres have also instituted welfare schemes for the benefit of their operatives in Madras, Nagpur, Jamshedpur, and Cawnpore. The welfare work carried on by the Buckingham and Carnatic Mills in Madras for several years past is well known. At Nagpur the Empress Mills have entrusted the task of looking after the welfare of their employees to the Y. M. C. A. The Board of Directors of the Tata Steel and Iron Company at Jamshedpur have put forward the claim that 'the attitude of the company from its earliest days towards labour and its provision of housing, education, welfare, water-supply, drainage, hospital, and other public services on a scale unexcelled in India, have met with the approval of public men of all shades of thought'. At Cawnpore, the British India Corporation have provided for a Welfare Superintendent to manage the two settlements that have been built to house their workers. So also some of the municipalities, like the Bombay Corporation, Port Trust and public utility services, especially railways, have taken certain steps to promote the welfare of their employees. Lastly, several social service agencies, such as the Bombay Social Service League started by the Servants of India Society, and similar leagues in Madras and Bengal, the Seva Sadan Society, the Bombay Presidency Women's Council, the Maternity and Infant Welfare Association, the Y. M. C. A., the Depressed Classes Mission Society, the missionary societies, are all playing a useful part in the organization of welfare work both by helping employers of labour and by independent efforts.

§47. **Items of welfare work.**—(i) *Education.*—The unsatisfactory position regarding the education of industrial workers has already been noticed.[2] Some enlightened employers of labour like the Tatas have arranged for the education of the children and adult operatives in day and night schools.. The Social Service League of Bombay and the Y. M. C. A. have also done much to promote the education of the industrial workers in schools as well as by provision of reading rooms and libraries. (ii) *Medical aid.*—The provision of facilities for medical attendance appears to be fairly general in the large and important factories in India, though it is rare to find the needs of female workers met by the appointment

[1] For particulars regarding the welfare work undertaken by the textile employers in the Bombay Presidency, see *Report on Wages, Hours of Work, and Conditions of Employment in the Textile Industries in the Bombay Presidency*, published in 1937 in connexion with the General Wage Census.

[2] See ch. i, §§13–14.

of special lady doctors. (iii) *Maternity benefits.*—In the interests of women workers and their children Western countries have introduced maternity benefits and prohibition of employment of women for some period before and after child-birth. The fact that women workers in India are also domestic drudges makes similar arrangements here all the more important. The Washington International Labour Conference of 1919 adopted a draft convention concerning the employment of women before and after child-birth. While India was not expected to ratify the convention immediately, the Government of India were invited to make a study of the question, including the grant of maternity benefits, and to report to the next Conference. The inquiries in connexion with the report submitted showed that such schemes had been instituted only by very few employers of labour. The reporting Provincial Governments, however, expressed their willingness to encourage the institution of further voluntary schemes. Additional inquiries made by the Government of India in June 1924, in conformity with the suggestion of the Assembly, showed that, in the three big organized industries of Bengal, namely jute, tea and coal, there were several definite schemes of maternity benefits. In the tea gardens in Assam, and the Assam Railways and Trading Company, in the mines of Bihar and Orissa, in the factories of Bombay, Madras and the Central Provinces, there are a large number of these schemes in operation, under which several concessions are allowed, such as grant of leave for varying periods during pregnancy, supply of free milk and feeding bottles, etc. Over and above all this, Bombay has a growing number of maternity homes. In her final report, Dr Barnes, the lady doctor appointed by the Bombay Government in connexion with maternity benefits to women workers, gives interesting details regarding the maternity allowances granted by the Tata group of mills. Two months' wages are given as allowance (one month before and one month after confinement) to a woman worker with a service of at least eleven months to her credit, on production of a certificate from a lady doctor regarding the completion of eight months of pregnancy and on her giving an undertaking not to work for a wage anywhere else.

In 1924 Mr Joshi introduced, in the September session of the Assembly, a Bill to regulate the employment, some time before and after confinement, of women in factories and mines, and on estates to which the Assam Labour and Emigration Act of 1901 applied, and to make provision for the payment of maternity benefits. It provided for the grant of leave six weeks before and after confinement and of maternity allowances by Local Governments from a maternity benefit fund subscribed to by employers of labour.

The Bill was rejected by the Assembly on the ground that it was too much in advance of public opinion in India. Similar legislation was, however, passed for Bombay in the form of the Bombay Maternity Act (1929). It applies in the first instance to certain selected cities in the Presidency but can be extended to other places by the Government. The Act, as amended in 1934, prohibits the employment of a woman during four weeks immediately following the day of delivery, and makes it illegal for her to work in any factory during this period. Maternity benefit at the rate of eight annas a day for the actual period of absence not exceeding four weeks before confinement and four weeks immediately after confinement, can be claimed by a woman from her employer provided she has been employed in his factory for not less than nine months immediately preceding the date on which she notifies her intention to absent herself from work owing to approaching confinement within one month next following. If, however, she works in any factory during the period of leave granted her, she forfeits her claim to the maternity benefit. A Maternity Benefit Act of limited application was also passed in the Central Provinces in 1930. The Madras Maternity Benefit Act (1935) closely follows the provisions of the Bombay Act. Legislation of this type, however, requires to be passed on an all-India basis so that employers in all the provinces are equally made subject to the obligations imposed by it. (iv) *Recreation.*—The value of recreation hardly needs to be specially stressed. Anything should be welcome that adds a little colour to the life of the worker, which for the most part is set in grey. It is also most important to induce the worker to utilize his spare time so that he is kept away from the liquor shop and the bucket-shop and generally to increase the attractions of industrial work in the towns and make him less reluctant to settle down permanently at the industrial centres. In this connexion, the activities of the Social Service League, Bombay, which has organized a Working Men's Institute at Parel, and of some enlightened employers like the Tatas and the Buckingham and Carnatic Mills, Madras, deserve special mention. As a result of these activities provision is made for outdoor sports and indoor games, entertainments, such as cinema shows, magic lantern lectures, musical concerts, dramatic performances, wrestling matches, etc. (v) *Housing.*—This question has already been fully discussed earlier in the chapter. (vi) *Co-operative societies.*—The work done by co-operative societies for industrial workers has already been alluded to in the chapter on the co-operative movement.[1]

[1] See vol. I, ch. x.

(vii) *Grain and cloth shops.*—Some mills maintain shops where cheap grain and cloth are sold to the workmen, thus preventing them from being swindled by the *bania,* though the more elastic credit given by the *bania* offers a great temptation to the workers to make their purchases from him, a tendency fostered by the degeneration of some of the mill shops into 'truck' shops. The only satisfactory solution lies in the organization of co-operative stores. (viii) *Teashops and canteens.*—There is a very meagre provision of teashops and canteens though there is an imperative need for proper facilities for obtaining good and wholesome tea and cooked food. There are only a few canteens of the type which have made considerable progress in England under the stress of War production. Caste difficulties and the conservatism of women have acted as great obstacles. It is important, however, to make every effort to overcome these difficulties in order to improve the health and the sobriety of the workman.

The most recent amendment of the Factories Act noticed above (§33) contains several provisions in connexion with welfare, for example maintenance of adequate shelters for rest, reservation of rooms for the use of children of women employed in factories employing more than fifty women, provision of first aid appliances, etc. Not only does welfare work require to be greatly extended in India but it should also be controlled more and more by the workers themselves. At present it is largely controlled by employers, and this impinges upon trade union organization and its activities. The selection of leading workers to associate with the management of welfare committees is scarcely a satisfactory arrangement as it tends to detach them from the general body of workers.[1]

[1] See *Report on Labour Conditions in India* (British Trade Union Congress Delegation 1928), p. 12.

CHAPTER IV

THE NATIONAL DIVIDEND

§1. **Estimates of national dividend in India: Dadabhai Naoroji's estimate.**—Various estimates have been made from time to time of the national income of India, and although they have varied widely, even the most optimistic of them have but served to emphasize the fact that the inhabitants of this country are beset with a poverty for which there is no parallel in modern times in the countries of Western Europe.

We shall now proceed to notice briefly the results of the principal estimates of the national income of India made by different writers so far. The first serious attempt in the direction was that of Mr Dadabhai Naoroji in his well-known book, *Poverty and Un-British Rule in India.* This estimate is based on official figures relating to the years 1867-70. Mr Naoroji explains the principles he followed in these words:—'The principle of my calculations is briefly this: I have taken the largest one or two kinds of produce of a province to represent all its produce. I have taken the whole cultivated area of each district, the produce per acre, and the price of the produce; and simple multiplication and addition will give you both the quantity and value of the total produce. From it, also, you can get the correct average of produce per acre, and of prices for the whole produce, as in this way you have all the necessary elements taken into account.' Working on this basis he arrives at the figure of £277,000,000 as the value of the gross agricultural produce. From this he deducts six per cent for seed. The balance left amounts to £260,000,000 representing 'the produce of cultivation during a good season, for human use and consumption for a year'. Next, £17,000,000 is taken as the value of salt, opium, coal, and profits of commerce. The value of manufactures is put down at £15,000,000. An equal amount is allowed for the annual produce of stock, fish, milk, meat, etc. and £30,000,000 is further added for any contingency. All these items add up to £340,000,000 and taking the population at 170,000,000, the *per capita* income for British India comes to 40s. or Rs. 20 per head. Mr Naoroji then proceeds to show on the basis of jail dietaries and rations for emigrant coolies, etc. that this is less than the Rs. 34 or so which is required for bare subsistence, and he comes to this conclusion:—'Even for such food and clothing as a criminal obtains, there is hardly enough of production even in

a good season, leaving alone all little luxuries, all social and religious wants, all expenses on occasions of joy and sorrow, and any provision for a bad season. . . . Such appears to be the condition of the masses of India. They do not get enough to provide the bare necessaries of life."[1] 'As the balance of income every year available for the use of the people of India did not suffice for the wants of the year, the capital wealth of the country was being drawn upon, and the country went on becoming poorer and poorer and more and more weakened in its capacities of production.' The reason which Mr Naoroji advanced for not including services in his computation was that they are ultimately paid for from the material produce, and since the latter is counted, including the services in addition would lead to double counting. From this he proceeds to the wider generalization that the annual material production of the country is the sole fountain head and that there are no other sources outside this production from which any individual can derive his share of the national income. This argument has been repeated in essence by K. T. Shah and K. J. Khambatta in their work, *The Wealth and Taxable Capacity of India.*

§2. **National income between 1875 and 1911.**—The next inquiry to be noticed after that of Mr Naoroji was undertaken in 1882 by Earl Cromer (then Major Evelyn Baring) and Sir (then Mr) David Barbour, and their results were as follows:—[2]

Agricultural income	..	Rs. 350,00,00,000
Non-agricultural income	..	Rs. 175,00,00,000
Total income	.	Rs. 525,00,00,000

Divided amongst 194,539,000 people, which was the figure for the population at that time, the average amount per head came to Rs. 27.

We may next notice Digby's estimate which proceeded on the assumption that the Government land revenue bears a definite relation to the outturn, and the percentage between the total outturn and the land revenue was taken at a varying figure as arrived at by Romesh Chundra Dutt and used by him in his *Open Letters to Lord Curzon.* The percentages were as follows:—

In Bengal	5 to 6 per cent	
,, the N.-W. Provinces	8 ,, ,,	
,, the Punjab	10 ,, ,,	
,, Madras	12 to 31 ,, ,,	say 20
,, Bombay	20 to 33 ,, ,,	say 25

[1] Op. cit., p. 31

[2] See W. Digby, *Prosperous India*, p. 366.

Shah and Khambatta object to this method on the ground that it is not only untrustworthy but also involves *petitio principii* as ' it tries to find out the gross product from the multiplier which itself can only be obtained from the gross product; the result will depend upon what multiplier you select '.[1] We are unable to follow this argument. The multiplier no doubt is found as the result of investigations into a certain number of sample cases, but obviously not all the cases are taken into account, and, therefore, we cannot see how an argument in a circle is involved in this procedure.

Digby's calculation yielded the following results:—

Agricultural income for 1898-9		Rs. 285,00,00,000	£189,000,000
Non-agricultural income (half above)	,,	Rs. 143,00,00,000	£ 95,000,000
	Total ...	Rs. 428,00,00,000	£284,000,000

Divided among 24,50,00,000 people, which, according to the calculations of the Government of India, was the probable figure for the population, the average income would on this basis be Rs. 17-8-5. The census of 1901, however, returned only 23,10,00,000 as the total population. On this basis the *per capita* income would be Rs. 18-8-11, *in a good year.* For the famine year 1899-1900, Digby calculated it would be as low as Rs. 12-6-0.

Lord Curzon, in reply to this and other similar statements, worked out his own estimate on the basis of the figures collected for the Famine Commission of 1898, giving the latest estimate of the value of agricultural income in India, which was placed at Rs. 450,00,00,000. The calculations of 1880 had shown the average agricultural income to be Rs. 18 per head and, taking the figures of the latest census for the same area as was covered by the earlier computation, it was found that the agricultural income had increased to Rs. 20 per head. Assuming that the non-agricultural income had also increased in the same ratio, the average income would come to Rs. 30 per head in 1900 as against Rs. 27 in 1880. Lord Curzon admitted that the data were not incontrovertible, but he pleaded that the figures of 1880 were also to a certain extent conjectural and that, if one set of figures was to be used in argument, so equally might the other. He also admitted that the advance in economic position revealed by the calculations was not in itself ' very brilliant or gratifying '. But at the same time they showed that the movement was in a forward and not in a retrograde direction.

[1] Shah and Khambatta, *The Wealth and Taxable Capacity of India*, pp. 66-7.

Digby, now again returned to the charge and re-examined the question in order to show that Lord Curzon's estimate erred too much on the side of optimism. As regards agricultural income he adopted the same old plan of deducing it from the land revenue. But in the case of the non-agricultural income, instead of assuming it to be half of the agricultural income, he examined a large number of items and came to the conclusion that the total income of the country was £259,000,000 which, divided among a population of 226,000,000 people, gave Rs. 17-4 as the average income per head.

Sir J. D. Rees quotes F. J. Atkinson in his book, *The Real India*, to the effect that, between 1875 and 1895, there was an increase in the income per head from Rs. 25 to Rs. 34. In February 1921, the Honble. E. M. Cook declared in the Council of State that, following the same method of calculation as was adopted in 1882 and 1901, the *per capita* income of 1911 had risen to Rs. 50. He further pointed out that a more elaborate and less defective method of computation would take the figure up to Rs. 80.

§3. **Wadia and Joshi's estimate.**—P. A. Wadia and G. N. Joshi have worked out an estimate of the national income of India with reference to the year 1913-14.[1] We may briefly indicate the results of their inquiry. The agricultural production is put down at Rs. 1,072,99,93,282, from which is deducted 20 per cent as the amount invested or set apart for seeds, manure, etc. This gives a net figure of Rs. 858,39,94,626. As regards mineral production the gross value is calculated at Rs. 14,40,95,000, from which 20 per cent is again deducted for depreciation in value and the working cost so far as it affects wages (mineral production having been included in the value of manufactures estimated at a later stage of the calculation). We thus get a net valuation of Rs. 11,52,76,000. Next follows the valuation of various products, such as hides and skins, manures, wool, silk, poultry products, on the assumption that exports of these products amount to 80 per cent of the total production. To this is added the value of the products of fisheries calculated at 4 annas per head for 275 days for 865,000 persons engaged in fisheries. The final addition is in connexion with the valuation of products worked by artisans, and earnings of labourers engaged in trade and transport, at 4 annas per head per day for 310 days for 18,000,000 persons. All this works out at a total of Rs. 154,29,58,750. The next item dealt with is the produce of the live-stock. The figures taken in this connexion relate to the year 1917-18 and it is assumed that the difference

[1] *The Wealth of India*, pp. 97-112.

between the number of cattle in this year and that in 1913-14 could not be appreciable. The total annual value of all the cattle is estimated at Rs. 349,05,11,518, from which the value of the services of cattle for agricultural purposes is deducted to prevent duplicate reckoning, seeing that these services are already included in the value of agricultural production as given above. As regards the added value of manufactures, this is arrived at by taking it to be one-fifth or 20 per cent of the gross total of raw materials (Rs. 204,76,65,000). This gives us the figure of Rs. 40,95,33,000. The authors proceed to make various deductions from the total gross income arrived at by the method described above, and they give the following statement showing the various sums to be deducted from the aggregate national income in 1913-14:—

1.	Home charges	£20,000,000
2.	Investment of foreign capital on behalf of the Government	8,000,000
3.	Profits on foreign capital invested in India	39,009,000
4.	Investment of new foreign capital in India	5,000,000[1]
5.	Remittances of money from India on private account by Government officers, European employees in banks, joint-stock companies, etc.	10,000,000
		£82,000,000
		= Rs. 123,00,00,000

The following table thus sums up the results of Wadia and Joshi's estimate.

Total Annual Income or National Dividend of British India in 1913-14

	Total valuation in rupees
1. Agricultural production	858,39,94,626
2. Mineral production	11,52,76,000
3. Miscellaneous products and earnings of artisans, etc.	154,29,58,750
4. Produce of live-stock	145,10,34,634
5. Manufactures	40,95,33,000
Total net valuation	1,210,27,97,010
Deduct for home charges, etc.	123,00,00,000
Net annual income	1,087,27,97,010

[1] The authors of the Bowley-Robertson Report point out that the value of this item has been deducted twice instead of once.

Dividing this net income by the total population of British India, namely 245,189,716, we get as the annual income per head Rs. 44-5-6 or £2-19-1.

The population of British India according to the census of 1911 was 244,189,716. To this has been added 1,000,000 as representing the possible increase in numbers in three years.

§4. **Shah and Khambatta's estimate.**—Shah and Khambatta's estimate is summarized in the following table.[1]

Items	Pre-War period 1900-14	War and post-War period 1914-22	Whole period 1900-22	Year 1921-2
		(Crores of rupees)		
Agricultural produce ..	1014·8	1686·5	1257·1	2155·8
Deduct for seeds	20	35	25	58
Net agricultural produce ...	994·8	1651·5	1232·1	2097·8
Forest wealth ..	10	20	14	28
Fisheries ...	1·2	2·5	1·9	3·2
Manufactures ...	80	150	106	186
Mineral wealth ...	10	21·6	14	28·7
Buildings, etc.	10	16·4	12	20·3
Total ...	1106	1862	1380	2364

This gives the *per capita* gross income of	Rs. 36 for 1900-14 Rs. 58½ for 1914-22 Rs. 44½ for 1900-22 Rs. 74 for 1921-2

Making an adjustment with reference to the change in the level of prices the income is stated at the pre-War average price-level as amounting to Rs. 36 per head for the pre-War period and Rs. 38-2 for the War and the post-War periods. From the gross income the authors make a number of deductions on account of home charges, etc. and come to the conclusion that this 'drain' takes about Rs. 7 away from the *per capita* income for 1921-2, reducing it to Rs. 67.

§5. **Findlay Shirras's estimates.**—In the estimate made by G. Findlay Shirras for the years 1920-1 and 1921-2,[2] he puts the

[1] op. cit., pp. 199-200.

[2] In 1921, the Statistical Branch of the Madras Department of Agriculture published an estimate which showed that the total agricultural income in the Presidency amounted to Rs. 309·7 crores. The agricultural population in the Madras Presidency is about five-sevenths of the total population, and if it is assumed that the contribution of the agricultural population to that of the non-agricultural population is in proportion to strength, the total non-agricultural income would be two-fifths of the agricultural income. This takes the total

agricultural income for the former year at 171,494 lakhs of rupees and for the latter at 198,341 lakhs of rupees, and the non-agricultural income at 883 crores of rupees. On this basis the *per capita* income comes to Rs. 107 for 1921, and Rs. 116 for 1922. Shirras points out that, in all the inquiries between 1881 and 1911, it had been assumed that the gross income of agriculturists and non-agriculturists was distributed between the two classes in proportion to their numbers. This worked satisfactorily enough so long as the country was industrialized only to a small degree. But during the previous few years rapid changes had taken place and some additional allowance was therefore necessary in order to arrive at the total non-agricultural income,[1] and the addition of Rs. 75 crores appeared to meet the requirements of the case, giving the total of Rs. 883 crores: One of the obvious criticisms of Shirras's estimate is that, contrary to the usual practice, he makes no deductions on account of seed in computing the agricultural income. It should further be noted that the non-agricultural income is about 40 per cent of the agricultural income in Shirras's estimate, whereas it is only about 10 per cent in Shah and Khambatta's estimate and about 30 per cent in that of Wadia and Joshi. This disparity is due, among other things, to the difference in the treatment of the service utilities. Shah and Khambatta exclude the services from their computation, whereas Shirras includes them.

We may now present in tabular form the results of the different inquiries which we have discussed.

Estimates by	Relating to year	Income per head Rs.	A.	P.
Dadabhai Naoroji	1870	20	0	0
Baring-Barbour	1882	27	0	0
Digby	1898-9	18	9	0
Lord Curzon	1900	30	0	0
Digby	1900	17	4	0
Atkinson	1875	25	0	0
	1895	34	0	0
	1911	50	0	0
		80	0	0
Wadia and Joshi	1913-14	44	5	6
Shah and Khambatta	1921-2	67	0	0
Shirras	1921	107	0	0
	1922	116	0	0

income up to Rs. 434 crores. The population of Madras according to the census of 1921 was 43·3 millions, so that the average income per head works out at about Rs. 100. If allowance is made for the rise in prices between 1899 and 1920, this would correspond to Rs. 42 in 1899, thus showing a real increase in income of 40 per cent. See Pillai, *Economic Conditions in India*, p. 44.

[1] *The Science of Public Finance* (second edition), pp. 138-45.

The following figures have been worked out for each of the ten years in the period 1923-32.[1]

Year	*Per capita* income in rupees	Year	*Per capita* income in rupees
1923-4	117	1928-9	106
1924-5	126	1929-30	109
1925-6	114	1930-1	84
1926-7	108	1931-2	63
1927-8	108	1932-3	58

Sir M. Visvesaraya in his *Planned Economy for India* (p. 27) suggests that the average income for British India in a normal year may be taken at about Rs. 82 per head of the population. In the recent slump, it would be correct to take the average at about two-thirds of the normal, or Rs. 55 per head.

§6. **Difficulties of interpretation and comparison.**—In comparing these results the reader must bear in mind several cautions. The first is that they relate to different dates and, before a comparative analysis is made of the economic condition of the people as between one date and another, the difference in prices at the two dates must be taken into account. Thus, Rs. 45 in 1913-14 would be equivalent to Rs. 81 in 1921-2 on the assumption of an 80 per cent rise of prices. Another fact to be remembered is that the area covered by the computations is not in every case the same. For instance, Shah and Khambatta include not only British India but also the Indian States, and if a comparison is to be instituted between their estimate and another one which is limited to British India, we should probably have to raise the *per capita* figure of Shah and Khambatta somewhat, assuming that British India is slightly richer and economically more advanced than the Indian States taken as a whole. We must further allow for the difference in the methods adopted in the inquiries. We have already seen, for example, that Shirras does not make any deductions, whereas the other estimates make them to a smaller or greater extent. Again, we must remember that there is a difference of treatment arising from divergent views as to the constituent elements in the national dividend. As we have seen above, Shirras's estimate includes the incomes of the professional classes,[2] while they are deliberately excluded in some of the other estimates. In order to institute profitable comparisons

[1] G. Findlay Shirras, *The Science of Public Finance* (third edition), p. 251.

[2] Shirras does not explicitly include services in his main estimate, but he checks his figures for non-agricultural income by a table in which the valuation of services is included.

between the results of inquiries relating to two different periods, we must not take the actual figures as they are given, but as they would have been if the methods adopted had been identical. Another point to notice is that, generally speaking, the later valuations are on a more scientific and careful basis; and as Shirras points out, if the old methods were followed in preference to his more elaborate method, the values of agricultural produce and non-agricultural income in his estimates would be appreciably lower.

Care is also necessary in drawing inferences about economic welfare from the *per capita* income. Here it is important to consider not only the average income per head but also the composition of the national income. In the case of India, for instance, an inquiry as to how much of the national income is in the form of food-stuffs would be specially pertinent. For, if the supply of an absolute necessary of life is disclosed to be insufficient, additions to the national income in other forms cannot be regarded as of the same order of importance as food-stuffs. Again, if services are included in the computation, the semi-political question whether some of the services are not overvalued in India cannot be ignored.

Lastly, we feel bound to utter a general caution, namely, that in considering the result of any particular inquiry we must take into account the spirit and purpose underlying it. A good many of the investigations referred to above have been admittedly informed by a spirit of political controversy. Not infrequently we find the course of the investigation interrupted by ~~road-side notices~~ that the particular valuation is a deliberate underestimate or overestimate as the case may be. If these protestations are to be taken seriously and literally, then the final results must be interpreted in their light. That is to say, if the author of a particular estimate declares that his estimate is above the correct figure, then we must reduce the figure somewhat, if on the contrary, we are assured that we are dealing with a deliberate underestimate, we must make a suitable addition. The curious thing, however, is that the pretended underestimates almost invariably give us a higher figure than the pretended overestimates, because liberal concessions granted to rival disputants 'for the sake of argument' in one direction are more than made up for by quietly taking liberties the effect of which is to swing the pendulum violently in the opposite direction.

In spite of the discrepancies in the results obtained by the different investigators, one fact which clearly stands out from all of them is the intense poverty of India. Even as regards a prime necessity of life, such as food, a large proportion of people in this country cannot afford to buy the necessary amount of it required for their bare physical needs. The validity of this statement is not

affected by the inconclusive evidence to which we have referred as regards the question whether the food-supply of the country is increasing in proportion to the increase in population.[1] Whether or not the aggregate food-supply is inadequate, and, if so, whether the inadequacy is increasing or not, the fact is beyond dispute, that a distressingly large number of the people are in a semi-starved condition.[2]

Sometimes, however, the picture of extreme poverty gets over-drawn by people arguing as if the *per capita* income were the income of an average family. We should be making the opposite mistake of supposing that the condition of the masses is better than it really is, if we did not remember that the national income is very unevenly distributed. Some people enjoy very much more than the average income and some very much less. The learned professions and the bigger landowners, for instance, enjoy a very much higher income than the cultivators or industrial labourers. The petty traders and shopkeepers have incomes of a medium size. Shah and Khambatta give the following figures to show the uneven distribution of the national income in India.[3]

'6,000 individuals, with an average income per head of Rs. 100,000 per annum absorb Rs. 60,00,00,000 among them, and support 30,000 persons.

230,000 individuals paying income-taxes with an average income of Rs. (?) supporting 1,150,000 persons.

270,000 individuals escaping or exempted from the income-tax, but having an income liable to that tax, with an average income of Rs. 5,000 per head per annum, absorb among them Rs. 135,00,00,000 and support 1,350,000 persons.

2,500,000 individuals with an average annual income of Rs. 1,000 absorb among them Rs. 250,00,00,000 and support 12,500,000 persons.

35,000,000 individuals with an average income of Rs. 200 per annum absorb among them Rs. 70,00,00,000 and support 100,000,000 persons.

The remainder have an average income of about Rs. 50 per annum and absorb among them Rs. 825 crores.'

The result of this calculation is that more than a third of the wealth of the country is enjoyed by about one per cent of the population, or, allowing for the dependants, about 5 per cent at

[1] See vol. I, ch. iii, §31.

[2] C. N. Vakil and S. K. Muranjan support the view that the food-supply is not only inadequate, but that the inadequacy is progressively on the increase (*Currency and Prices in India*, p. 363).

[3] op. cit., p. 307.

most; that slightly more than another third, about 35 per cent of the annual wealth produced in the country, is absorbed by another third of the population, allowing for the dependants; while 60 per cent of the people of British India enjoy among them about 30 per cent of the total wealth produced in the country.

It should also be remembered that the *per capita* income varies from province to province.[1] It would be larger in those provinces which grow commercial crops and which are relatively more industrialized, such as Bombay, Sind, the Punjab, Assam, the Central Provinces and Berar, whereas Bihar, Orissa, the United Provinces and Madras are relatively poorer provinces.

§7. **International comparisons.**—International comparisons cannot be based merely on a consideration of the *per capita* income of the countries under comparison. Sir Robert Griffen drew attention to the dangers of making these comparisons without introducing the necessary qualifications and of assuming 'that figures called by the same names in different countries have exactly the same values'. Figures of the income per head do not tell us much about the economic well-being of the people of one country as compared to people belonging to another unless we allow for such factors as differences in standards of living, habits and customs. As Sir Josiah Stamp points out: 'In the countries to be compared, men must care for the same objects in a similar way, and their scale of relative values must be akin. To the extent to which countries diverge in this respect, the comparison will be invalid.'[2] The same income per head, for example, would obviously have an entirely different significance in two countries so wide apart from each other as India and England, because the scale of values is different, not only owing to difference in taste but also because external conditions impose different standards of requirements. Broadly speaking, owing to the warmer climate of India, an appreciably smaller expenditure is required on food, clothing, fuel and housing than in England. However, when every allowance is made for

[1] See Vakil and Muranjan, op. cit., pp. 356-7.

[2] Cf. 'It is very doubtful whether numerical comparison can be safely made between two countries; neither housing, clothing nor food are comparable. The importance of that part of income which is not wages varies greatly, and many things must be bought in one country which are unnecessary or are home-made, home-grown, or obtained freely in another. Nor should we compare industrial classes, such as workmen, engaged in building, engineering or printing, in different countries, since methods and conditions of work vary enormously, unless we make very broad allowances for the possible effects of such variation.'—A. L. Bowley, *The Nature and Purpose of the Measurement of Social Phenomena*, quoted in *Economic Inquiry Committee Report*, p. 117.

these factors, the following figures[1] are sufficiently eloquent and show the tremendous distance between India and some other countries as regards economic prosperity.[2]

Country	Year	£ *per capita* income		Year	£ *per capita* income
British India ...	1931	5	Germany ...	1925	39
United Kingdom	1931	76	Italy ...	1927	24
Australia ...	1924	98	Egypt ...	1928	21
United States ...	1932	89	Japan ...	1925	14
France ...	1928	41	Bulgaria ...	1932	9
Czechoslovakia ..	1925	35	U.S.S.R. (Russia)	1925	10
Denmark ...	1927	55			

It is clear that most of the countries mentioned in the table above are far ahead of India and we seem to come within the same 'universe of discourse' only when we leave the more progressive countries alone and seek comparison with some of the backward countries of Eastern Europe like Bulgaria or with Soviet Russia in the throes of transformation.

§8. **Intensive inquiries.**—Besides computations of the national income per head, various intensive village and regional inquiries

[1] See Shirras, *Poverty and Kindred Economic Problems in India* (third edition), pp. 44-5.

[2] The Simon Commission remark that even if the most optimistic estimates (Rs. 107 in 1920-1, and Rs. 116 in 1921-2 according to Shirras) are accepted, the result is that the average income of India per head in 1922 was equivalent, at the prevailing rate of exchange, to less than £8, while the corresponding figure for Great Britain was £95. 'The contrast remains startling even after allowing for the difference between the range of needs to be satisfied.'—*Simon Commission Report*, vol. I, par. 374.

The Central Banking Inquiry Committee point out that 'the income of the agricultural population when separately assessed will be much smaller. From the reports of the provincial committees and other published statistical information the total gross value of the annual agricultural produce would work out to about Rs. 1,200 crores on the basis of the 1928 price-levels. On this basis and taking into consideration the probable income from certain subsidiary occupations estimated at 20 per cent of the agricultural income, and ignoring the rise in population in the last decade and the fall in prices since 1928, the average income of an agriculturist in British India does not work out at a higher figure than about Rs. 42 or a little over £3 a year.'—*Report*, p. 10.

have been made by different investigators, such as Dr Mann in Bombay and Dr Slater in Madras. For the village Pimpla Soudagar (1917) Dr Mann works out an income of Rs. 218 per family, or an income per head of Rs. 43-3-0, obtained in an average good year. The expenditure per family of five persons is given as Rs. 200-8-0 after the payment of *balutas* and interest charges on debt. To this figure Dr Mann adds Rs. 11-10-0 in view of the larger proportion of adults in the village than in the ideal family for which the calculation was made. This gives Rs. 42-14-0 per head on the average for the 103 families for whom the records were complete. If *balutas* are included, in the case of cultivators' families (71 out of 103), the total expenditure per head would be Rs. 44. Assuming a normal year and ignoring payments on account of debts, this shows that the cultivators' families with an income of Rs. 44 per head would just pay their way. But, of course, the existence of debt entirely alters the situation, and Dr Mann is brought to the conclusion that 'out of 103 families investigated, only 36 or just under 35 per cent, can pay their way on the standard they themselves lay down. The others are living below that standard, and this conclusion, which seems very clear, forms an exceedingly serious state of affairs'. Dr Mann's study of another village of the Deccan, Jategaon Budruk, led to a similar result. Major Jack's inquiries (1910-14) into the economic conditions in the Faridpur District in Bengal yielded the following results:—

Classified as living	Persons	Income per head (in rupees)
in comfort	951,205	65
below comfort	524,803	43
above indigence	319,315	32
in indigence	65,860	26
	1,861,183	(average income) 52

Several other intensive surveys have recently been made, for instance those carried out under the auspices of the Rural and Urban Sections of the Board of Economic Inquiry, Punjab. The Indian Central Cotton Committee has carried out eight investigations into the finance and marketing of cultivator's cotton, which were the first intensive inquiries of the sort recommended by the Indian

Economic Inquiry Committee and contain information of the utmost importance.[1] All these investigations generally corroborate the conclusions as stated above about the economic condition of the people.

§9. **Is Indian poverty on the decline?**—Granting the existence of appalling poverty as an indisputable fact, the question whether it is increasing or diminishing, or whether there is no movement either way, has been variously answered. Wadia and Joshi hold that, during the twenty years between 1895 and 1914, the condition of the population did not undergo any change. The more common view, however, is that there was a real, if a very slow, amelioration in the condition of the people and that this progress has on the whole been maintained. That the people are getting more and more discontented is true, but as European experience shows, this is quite compatible with a great betterment in the economic position of the masses. With increasing wealth there generally comes an increase in the consciousness of poverty. A people may be so brutalized by extreme poverty as to lose all consciousness of it. But a little relief from poverty is commonly followed by a desire for still further relief. Modern economic advance has been accompanied by a great multiplication of human wants and the modes of satisfying them, so that poverty has come to mean not so much the inability to satisfy a few primal wants but rather the inability to share in the new known goods of each period. Although the masses are better fed, better clothed and better housed today in Western countries than fifty years ago, they are more discontented with their state than ever before. According to some observers, a similar change has come over the spirit of the people in India, and this is one of the results of a decided improvement in their economic condition. People are at present much better able to resist famines than in the past. The various estimates of national income we have set out above, in spite of their imperfections, do, on the whole, succeed in conveying an impression of gradual economic improvement. This impression is strengthened by such admitted tendencies as the growing independence of spirit displayed by agricultural as well as industrial labour. Again, there are on the whole good grounds for inferring that the *per capita* consumption of food as well as of cloth is gradually increasing. The official view in this country is that the amelioration is unquestionable, and the reasons generally advanced in support of it are well exemplified in the following quotation: 'So far as ordinary tests can be applied,

[1] See *General Report on Eight Investigations into Finance and Marketing of Cultivators' Cotton*, 1928.

the average Indian landholder, trader, ryot, or handicraftsman is better off than he was fifty years ago. He consumes more salt, more sugar, more tobacco, and far more imported luxuries and conveniences than he did a generation back. Where house-to-house inquiries have been made, it has been found that the average villager eats more food and has a better house than his father, that, to a considerable extent, brass and other metal vessels have taken the place of the coarse earthenware vessels of earlier times, and that his family possesses more clothes than formerly.'[1] The truth of this picture has been challenged by non-official observers and some of its details especially have been regarded as open to doubt. For example, the statement that the average villager eats more food has not been universally accepted. Possibly the average villager lays out his slightly increased income on a larger number of commodities than before, but he has not been able to increase his standard of diet. Indeed, there are reasons to suppose that in the villages, especially in those in the vicinity of towns, the dietary of the average villager has deteriorated and he is worse nourished than before. The average consumption of milk products, which occupies such an important position in a predominantly vegetarian diet, has distinctly fallen off. There does not seem to have occurred the addition of any substitute which can be regarded as of equal nutritional value (though it may be granted that the diet of the people has tended to become more varied owing to improved transport and communications). In view of the unsatisfactory nature of the available evidence, many people may prefer to suffer the inconvenience of a suspense of judgement on the question whether the national dividend is increasing, and also on the other quite different question, whether welfare apart from wealth is growing. But even assuming that there has been some increase in the wealth of the country it cannot be compared for a moment with the amazing advance achieved by Western countries like England in recent times—an advance reflected in the fall of pauperism, decrease of death-rate and poverty diseases, increase of wages, shortening of hours of labour, spread and improvement of education, increase in the means of recreation, better housing and sanitation, etc. There are indeed great inequalities in the distribution of wealth in the West, but there can be no question about the wide diffusion of economic well-being. The cheapness and plenty of the good things of life together with

[1] *Results of Indian Administration in the Past Fifty Years*, Cd. 4956, 1909. p. 26, quoted by L. C. A. Knowles, *The Economic Development of the British Overseas Empire, 1763-1911*, vol. I, p. 275.

the universal rise of incomes have brought within the reach of the masses many commodities and modes of enjoyment which were formerly the monopolies of the very rich and have resulted in what Vicomte D'Avenel calls '*le nivellement des jouissances*' (the levelling up of enjoyments).[1]

§10. **Need for better statistics.**—In pronouncing judgements on the various problems concerning the economic condition of the people in India it is found that nothing more than a halting, uncertain attitude is possible in the present circumstances for lack of precise statistical information. On everything else besides the obvious fact of extreme poverty we are left more or less in the dark. The collection of reliable statistical data will make our information more precise and minimize the large number of conjectural assumptions which are now unavoidable in every inquiry. It will also make possible a correct diagnosis of the numerous economic and social ills from which the country is suffering, and will be of great assistance in tackling the day-to-day problems of administration. The Indian Economic Inquiry Committee (1925) quote the following apposite remarks of *The* (London) *Times* in this connexion. Speaking of the Empire Statistics Conference, which sat in January and February 1921, it said: 'In Germany before the War the Statistical Bureaux were ceaselessly employed in working on everything that illuminated the future of the German people; and in the era which is now opening there can be little doubt that the nation which studies the drift of events as it is revealed by statistical analysis will be infinitely better equipped to take advantage of its opportunities than another which perhaps trusts only to the methods of empiricism.'[2] The statistics at present collected are often unco-ordinated and without expert direction and are generally a by-product of administration meant more for departmental use than for the purpose of affording information to the public about important social and economic activities.

It is indeed true that in India the collection of statistics is attended with extraordinary difficulties. In the first place, the huge size of the country makes the enterprise expensive and difficult to carry out. Secondly, the population is scattered in rural areas and not concentrated in big cities and towns. Thirdly, the existence of illiteracy makes the co-operation of the public in the work of gathering statistical data a practical impossibility. In Great Britain and the Dominions, the statistics of production, wages and prices are usually collected by distributing schedules to private individuals

[1] Georges D'Avenel, *Découvertes d'Histoire Sociale*, pp. 295-318.

[2] *Economic Inquiry Committee Report*, p. 4.

who are required to fill them up within a given time and return them. This is both a more accurate as well as a less expensive method than that of engaging a specially paid staff. Much assistance is also derived from the co-operation of a number of private associations, the like of which are almost entirely absent in India. Absence of organized enterprise and the existence of numerous small unorganized undertakings further make statistical work extraordinarily difficult.[1] However, although we cannot hope immediately to attain to the standard of equipment usual in Western countries, there can be no doubt that the present position in this regard in India admits of very considerable improvement. The Economic Inquiry Committee Report, as well as the Dissenting Note of Professor Burnett-Hurst, contains many useful suggestions as to how this might be done.

§11. **The Bowley-Robertson inquiry.**—In November 1933 the Government of India engaged the services of Professor A. L. Bowley of the London School of Economics and Mr D. H. Robertson, Lecturer in Economics at Cambridge, to advise them on the question of obtaining more accurate and detailed statistics and the practicability of carrying out a Census of Production. Associated with these two experts were three Indian economists, and the combined labours of these gentlemen have resulted in a valuable Report published in 1934 entitled *A Scheme for an Economic Census of India* of which the following is a brief summary.

§12. (i) **Organization of statistics.**—A permanent economic staff, directly attached to the Economic Committee of the Governor-General's Executive Council, should be established. The staff should consist of four members. The senior member should act as secretary to the Economic Committee of the Council, to whom he would be responsible for the organization of the whole work of economic intelligence. Thus he would have the duty of preparing reports on urgent questions as they arose from time to time, and for this purpose would need to organize the supply of current information on economic and commercial events abroad as well as at home. But it would also be his duty to be thinking further ahead, and to take the initiative in planning inquiries of a broader and more fundamental kind.

Two of the other members of the staff would be trained economists, while the third would be the Director of Statistics. So far as possible the staff would function as a staff and not as individuals, but since the field of economics is so wide that no

[1] See Professor Burnett-Hurst's Note of Dissent, *Economic Inquiry Committee Report*, pp. 91-2.

one man can cultivate the whole, the senior member and the two economic intelligence officers would divide the territory for exploration between them in accordance with their respective bents and capacities. It would be natural, for instance, that one of them should specialize in the study of the means of promoting the expansion (or, if that be the policy, the orderly contraction) of India's foreign trade, and the operation of tariffs and trade agreements. It is important that the two economic intelligence officers should work under conditions of the utmost freedom which is compatible with membership of a civil service. The whole staff would maintain the closest possible contact with certain other officers of the Government, including both some whose duties are primarily administrative and some whose duties are primarily technical and advisory. It would be within their competence to recommend to the Economic Committee of the Council the *ad hoc* engagement of external technical experts for the purpose of reporting on the economic potentialities of particular areas or of particular branches or processes of production.

The Director of Statistics, while being a member of, and the principal organ of information for, the permanent economic staff, should have his own peculiar duties, in the discharge of which he would enjoy a considerable degree of independence. These would include (*a*) the conduct of the population census, (*b*) the conduct of the census of production, (*c*) the co-ordination of central statistics, and (*d*) the co-ordination of provincial statistics. To assist him in these duties the existing Statistics Branch of the Department of Commercial Intelligence and Statistics would be transferred to his control and some addition to its permanent numbers would be required. The Commercial Intelligence Branch of this Department, which is mainly engaged in dealing with the inquiries of the commercial world, would become a branch of the Department of Commerce.

The census of production should be quinquennial; and while the main census of population continues to be decennial, a supplementary census with an abbreviated schedule of inquiries, mainly devoted to numbers, age, sex and occupation, should be taken in the middle of the decennium. The censuses of population and production should be as nearly synchronous as the requirements of tabulation permit. Preparation for the censuses and analysis of their results would provide nearly continuous work for a special section of the permanent statistical staff, which would expand on the occasion of the taking of the decennial population census into a larger organization.

The Director of Statistics should have power to consult with

those responsible for the preparation of statistics in all Departments, with a view to arranging for uniformity of classification, and for the furnishing of statistics needed for general purposes, without prejudice to the assembling of other data necessary for departmental use. He should be responsible for the publication of the Statistical Abstract.

There should be in each major province a whole-time statistician, as nearly independent of departmental control as administrative requirements permit, but making his services available to all departments, passing all their statistics under his review, conducting the population census under the direction of the central Director of Statistics, and co-operating with the latter in every possible way. Pending the establishment of such officers everywhere, it will be for the Director to establish such contact as he can in each province with whoever most nearly fills the bill, with a view to promoting uniformity in the provincial statistics and thus facilitating their assembly into all-India totals.

§13. (ii) **The measurement of national income.**—The authors of the Report remark that the materials at present available for estimating the national income and wealth of India are very defective, that the various estimates attempted so far are in any case out of date and that the problem now requires to be approached afresh *ab initio.*

The national income is the money measure of the aggregate of goods and services accruing to the inhabitants of a country during a year, including net increments to, or excluding net decrements from, their individual or collective wealth. It is probably best to ignore catastrophic decrements of wealth, such as might be caused by an earthquake or a severe epidemic of cattle plague.

As is well known, there are two methods of calculation, the first consisting in an evaluation of the goods and services accruing, the second in a summation of individual incomes. The two methods do not furnish a check on one another over the whole field; thus the services of Cabinet Ministers must be held to be worth the amount of their salaries, since there is no other way of evaluating them. In the case of India it seems unlikely that the first (census-of-production) method will ever be applicable over the whole even of the industrial field: and special caution in combining the results of the two methods may be necessary.

The first (census-of-production) method involves

(*a*) evaluating the net output of the various branches of 'productive' enterprises, agriculture, mining, industry, etc., at the point of production, being careful to avoid

double counting (for example counting *both* the output of wheat *and* the labour of the cattle employed in raising it).

(*b*) adding the value added to home-produced goods and to imports by transporting and merchanting agencies in the country.

(*c*) adding excises on home-produced goods.

(*d*) deducting the value of exports (f. o. b.), including gold and silver.

(*e*) adding the value of imports (c. i. f.), including gold and silver.

(*f*) adding customs duties on imports.

(*g*) deducting the value of goods, whether home-produced or imported, which are used for the purposes of maintaining fixed capital, or stocks of raw and finished goods, intact.

(*h*) adding the value of personal services of all kinds.

(*i*) adding the annual rental value of houses, whether rented or lived in by the owners.

(*j*) adding the increments in the holdings of balances and securities abroad, whether by individuals or the Government, or deducting the decrement in such holdings: and/or deducting the increment in the holdings of balances and securities in the country by residents abroad, or adding the decrement of such holdings.

Some of these processes call for further comment.

(*a*) That part of the product of agriculture, etc.—in India very large—which is consumed by the producer or bartered locally for services should be valued, like the rest of the outturn, at its price at the point of production, not at the retail price which consumers in distant markets pay, and which includes costs of handling, etc. which are not incurred on the home-consumed outturn.

(*c*), (*f*) This is necessary, because the total we are in search of is the aggregate of exchange-values *to the consumer.*

(*d*), (*e*) (*j*) It is easily seen that if the Government of India raise a loan in London for railway construction, the securities imported form part of the real income of the English investors, just as an import of Indian tea would do. The reverse side of the same truth is that the increment of capital wealth in India, which

is included in the evaluation of production or of imports, is balanced by a capital liability to foreigners, and must be deducted to arrive at the net income. The same considerations apply to changes in the ownership of bank balances, at home and abroad, and —in the case of India very important—to increases or decreases in the stock of precious metals, which for this purpose may be visualized as foreign securities.

(*h*) (1) Strictly speaking, it may be argued that only those services of Government servants should be included which confer direct utility—protection, amenity of life, etc.—as distinct from assisting to augment production, the value of the latter having already been included, like other costs of production, in the sale value of the product under (*a*). The subtleties to which this complication leads do not seem worth pursuing here; in what follows it will be assumed for simplicity that the services of *all* Government servants confer direct utility and form part of the real national income: deductions can be made to taste by those who please. These services should be valued at a sum which includes the pension rights accruing during the year to those who render them.

(2) In India the distinction between charitable gifts, which are not part of income, and the payment for services of a customary or religious nature is peculiarly indefinite; and the line drawn is bound to be somewhat arbitrary.

The census-of-production method above described is the more fundamental of the two methods of evaluating the national income. In order that the results of the second (census-of-incomes) method may tally with it, certain precautions in following this second method must be observed.

(*a*) All self-consumed produce and receipts in kind must be included in the individual's income, valued at their selling value at the point of production. So must the annual value of houses lived in by the owners.

(*b*) All interest payments, even on loans incurred for consumption purposes, must be deducted before entering the individual's income.

(*c*) Apart from this, the incomes of all individuals in the country, including interest on Government loans and pensions of ex-Government servants, should be entered gross, that is before payment of direct taxation

(including land revenue). The incomes of Government servants should be entered inclusive of pension rights accruing during the year. To the total so reached should be added the undistributed profits of companies and the net profits of Government enterprises. From the total so reached should be deducted the sum required to pay the interest on Government loans other than for productive enterprises, and the pensions of ex-Government servants, whether due at home or abroad.

(*d*) Rather oddly, receipts from customs and excise, stamp duties and local rates—that is all taxes which are of the nature of business costs—must be added to the total so far reached, for the latter is the aggregate of exchange-values accruing to producers, while the true national income, as calculated on the census-of-production method, is the aggregate of exchange-values accruing to consumers. Unless therefore this addition is made, discrepancy will arise.

The suggestions which are made below relate to the estimate of the broader sections of the national income; the various adjustments indicated above would have their place in a final calculation.

The authors do not recommend for India at present any estimate of national wealth as a whole. There are two methods followed elsewhere, neither of which is appropriate to India. The first is to capitalize the yield of all income-bearing property, including goodwill, assigning appropriate numbers of years' purchase to the rent of land and houses, dividends, interest, etc. and sometimes to add estimates of property publicly owned such as docks, railways, Government buildings, etc. The second is to use the statistics of property passing at death, obtained at probate, etc., and with the help of life tables to deduce the total value of property. This procedure is impossible in India since there are virtually no taxes on inheritance. As regards the first method there is certainly not enough information for the valuation of most of the important classes of individual property; and though the value of railways could be estimated, that of roads, of some irrigation works and of many other results of public expenditure defies measurement.

Though they cannot expect to measure, with any precision that would justify the attempt, the *total* of wealth, it may be possible to give some indications of its *change*, by series relating to public expenditure on permanent work, to investment of new capital and to other expenditure of the nature of capital outlay.

The investigation proposed for the purpose of estimating the national income is primarily on the basis of production, but as in similar estimates in all countries a minor part depends on individual incomes. In India the proportion to be thus estimated is probably greater in the towns, but much smaller in the aggregate than in Western countries. Partly owing to difference in the nature of the products and partly because different methods of investigation are necessary, rural income is distinguished from urban income.

For rural income they advocate an estimate of the quantity and value of all produce and services arising from the land or rendered in the villages, by the method of intensive surveys in selected villages.

For urban income they recommend in the first instance surveys of the larger towns on the method which has been successfully followed elsewhere. This is based on a sample inquiry of the personnel and occupations of families, and an estimate of their incomes partly by personal statements, partly by investigation of wages and salaries current in the towns. For incomes over Rs. 1,000, or at least over Rs. 2,000, income-tax statistics can afford valuable help.

They have recommended also an intermediate urban population census. These three inquiries would be supplemented by a census of production applied to factories using power, mines and some other industries. This would to a considerable extent overlap the urban survey and to a less extent the rural survey. But it is of considerable importance in itself and is calculated to furnish a more accurate account of part of the whole field than the other surveys. It is believed that when all the materials are assembled, means can be found to eliminate duplication by estimating the part of the income included both in the urban or rural surveys and the census of production, or by other methods.

It would remain to estimate, on the basis of population and of the results of the main surveys, the income of the smaller towns. Additional estimates may be needed for the tea plantations and any other special areas not included in the rural survey.

All the investigations should be extended to the Indian States so far as they are willing and able to co-operate. For areas not so included estimates will be necessary by the use of agricultural statistics.

These proposals will result in fairly precise estimates for large and definite sections of the income of the population and of the produce of the area of India. When these are established effort will be necessary to diminish the region of guesswork and to increase that of ascertained fact.

§14. (iii) **Census of production.**—The census of production would be imposed (as in Great Britain) by a special Act of the Central Legislature, making communication of the facts demanded compulsory. It would be conducted by the Director of Statistics, the executive arrangements presumably being made through the Department of Industries and Labour. It appears to be necessary to limit its scope, so far as English and American methods are followed, to the larger establishments; and the natural line which suggests itself is that drawn in the Factory Act, namely the employment of twenty or more persons combined with the use of mechanical power. It would not seem desirable to extend it automatically to those smaller establishments to which, for special reasons of no great statistical significance, provincial Governments have used their powers of extending the Factory Act. But on the one hand there may be *some* classes of small workshop to which the census could advantageously be extended, while on the other there are certainly some large non-mechanical establishments, for example in building and constructing, brick-making and carpet manufacture, which ought to be brought within its scope. So also should the railways and all establishments under the Mines Act.

The average number of operatives employed in factories in British India (excluding Burma) in 1932 was 1,330,000; though this forms only a small proportion of persons engaged in industry, this group is of special importance in relation to export, and for this and other reasons quite properly special attention has been given and should continue to be given to its study. It is to be remembered, however, that the progress of factory industry is to some extent at the expense of cottage industry, and it is of the greatest importance to bring the two in statistical relation to each other. There seems to be no possibility at present of making any exact estimates. The execution of the proposed rural and urban surveys will provide some data; accurate estimates of the crops of cotton, sugar and other agricultural products which are manufactured both in houses, etc., and in factories, are capable of giving more complete information. There is also a possibility of tabulating the census material relating to occupations in such a way as to show the whole numbers engaged in such occupations, so that when used in conjunction with the factory statistics some idea of the relative importance of the two organizations of industry could be obtained. The 1931 census of population in fact shows, as might be expected, that the numbers engaged in industry in British India as a whole are very much greater than those accounted for by the factory statistics. (While there is no immediate possibility of comparing the numbers in, or output of, factories with those in similar

cottage industries, it may be possible to obtain some annual data which would show their relative growth or decrease, when the whole of the survey now suggested is complete.)

A rural survey.—It is desired, as part of the survey of Indian income and resources, to obtain information in numerical form of the income (in cash or kind) derived from the land, and its distribution among owners, occupiers, labourers, etc. together with other items of village income.

It is impracticable to make direct investigation into the circumstances of each of the half-million villages in British India in any reasonably short time, even if the expense could be met or a sufficient number of investigators found. It is, therefore, necessary to proceed by sampling.[1]

Although financial exigencies do not permit immediate effect being given to all these recommendations which, it is estimated, will cost Rs. 30,00,000, it may be hoped that it will be possible in the near future to carry out a census of production which is essential for formulating correct economic policies. This hope has been strengthened by the recent (1937) appointment of Dr T. E. Gregory of the London School of Economics as Economic Adviser to the Government of India.

§15. **Causes of Indian poverty.**—The poverty of India is a highly complex phenomenon and the factors accounting for it are varied and innumerable. We have already discussed the view that the poverty of the people is in the last analysis due to a defect of outlook on their part, caused by a religion which is unworldly beyond any other.[2] People in India, so runs the argument, are too spiritually minded to care sufficiently for the production and accumulation of wealth. They seek to achieve contentment, not by increasing standards of living and then by struggling to satisfy these standards, but rather by a rigid limitation of all desire. Rather than add more fuel, they prefer to take away as much of the fire as possible. Other alleged causes are contempt for manual labour; the sufferance or even encouragement of thousands of parasites like the wandering *fakirs* and *bairagis* who are a burden on the community; the cramping influence of various religious prejudices and the existence of a number of anti-economic customs and traditions, such, for instance, as those which result in the withdrawal of a large number of women from all economic activities; unrestricted multiplication of numbers; various practices, like that of early marriage, which sap the physical vitality and, therefore,

[1] Bowley and Robertson, op. cit.
[2] See vol. I, ch. iv.

diminish the economic efficiency of the race; prevalence of diseases like malaria and hook-worm which have the same debilitating influence; the love of litigation, which is supposed to characterize the Indian people, whose delight in scoring points, it is said, makes the court of law such a haunt for them, etc. The administration is also blamed as being in no small measure responsible for the backwardness and the poverty of the country. The Government are accused of not having exerted themselves as much as they should have done to develop the economic resources of the country. Particularly are they charged with having failed to take the necessary steps to foster industrial development. Lastly, the theory of the 'drain' has served for many people as a sufficient explanation of Indian poverty. Some of these causes have already been dealt with in their appropriate places, and others like the 'drain' will be treated in the succeeding chapters.

§16. **Some errors of consumption as aggravating causes of Indian poverty.**—Whatever tends to reduce the productivity of the people must be regarded as a cause of poverty. But besides low production unwise consumption may also act as a drag on economic progress. Intelligent consumption or 'rational destruction of utilities' requires 'reflection, intelligence and imagination'.[1] Great wealth often breeds great wants, many of which are evil and unwholesome and, like undutiful children, eventually sink the wealth, from which they have sprung, down into poverty. But apart from the economic ruin which extravagant expenditure may bring on the possessors of great wealth, senseless expenditure on such luxuries as do not add anything to the fulness and richness of life is also injurious to the community, because it diverts so much capital and labour from the production of necessaries. Nor are the rich alone guilty of harmful extravagance. In most countries the poorest classes are, by reason of their very poverty, the most reckless and extravagant. The opposite vice of niggardliness masquerading as thrift, characterizes some sections of the people, particularly members of the middle classes, and certain communities like the *marwaris*, who often stint themselves and save where they ought to spend freely. It has been observed that regard for 'a fuller life in the present for the earner and a greater tendency to leave the succeeding generation, provided that it is well trained and equipped with personal capital, to look to its own welfare, [is] replacing the older view, which inculcated a slow accumulation of

[1] cf. 'To spend money well is a harder task than to earn money well. In earning, the task is generally prescribed, but in spending, the spender takes the initiative. It is no longer passive obedience, but a good will that is required.'—J. S. Nicholson, *Principles of Political Economy*, vol. III, p. 436.

savings in order that the children might start with a better equipment of material capital '.[1] This attitude is partly due to a real change in the psychology of the people, one of the many significant results of the War. But it is probably also due to some extent to the great rise in prices which took place after the War. The incomes of the middle classes did not rise in proportion to the rise in prices, and consequently the savings that they might have been able to make with economy and self-denial ceased to appear worth while owing to the reduced purchasing power of money. Indications are not wanting that a similar change, though on a smaller scale, is taking place in India in the attitude of the middle classes, whose standard of living has visibly risen during recent times. To some extent, this change ought to be welcome because real thrift often consists not in saving money but in spending it on an increase of well-being in the present, so as to make it promote well-being in the future. The unduly timid frugalities of some people as well as the reckless improvidence of others are alike censurable as impairing the economic strength of the nation. It is not possible here to deal in detail with the problem of consumption in India in all its aspects. There is, however, no doubt about the general truth of the contention that the evil of poverty in India, though mainly due to low production, is further aggravated by ill-regulated consumption, and we propose to dwell here more particularly on one form of unwise consumption which has recently excited much attention. It is scarcely necessary to point out that there is a vital relation between physical efficiency and diet. As the German proverb has it, 'A man is what he eats ' (*Man ist was er isst*). The dietary adopted by people in most of the provinces in India has so far been controlled by local circumstances and depended on the kind of food that can be grown on the spot. The consequence of this has been that the staple food of the people in some of the provinces is lacking in important nutrient substances. The differences in the physical efficiency of Indian races, such as the Sikhs, the Gurkhas, the Marathas, the Kanarese, the Bengalis and the Madrasis may be chiefly attributed to the differences in their staple diet, and have now been ' definitely correlated with differences in the biological value of foods which necessity, habit, or religious prejudice has forced them to use '. The researches of Lt.-Col. R. McCarrison and others in malnutrition as a cause of physical inefficiency and ill-health are very instructive and have shown the relative nutritional values of the national diets in India.

[1] W. H. Coates on the ' Report of the Committee on National Debt and Taxation', *Journal of the Royal Statistical Society* (1927), Vol. XC, Part II, p. 356.

They point out that rice, which is the chief food of many people in India, especially in Madras and Bengal, is fundamentally a poor diet, deficient in important organic salts, and one which does not furnish the undefined constituents of food called vitamins, whose importance has been revealed by modern investigations. The wheat- and meat-eating people like the Sikhs, Pathans and Gurkhas have a much better physique than the rice-eating Bengalis and Madrasis. The addition of wheat, milk, butter, meat, etc. greatly improves the rice-eater's diet, as in the case of the Marathas who take principally millets, such as *jawar* and *bajra,* and sometimes wheat and also milk. The daily use of unsuitable food insidiously undermines the constitution and this is a matter of far greater importance than is commonly realized. The problem of malnutrition is distinct from the problem of poverty, because diet is not simply a matter of securing an adequate quantity of food, but of achieving a correct balance of the constituents for the maintenance of health and vigour. As the Agricultural Commission point out, malnutrition and starvation are not the same. 'Actually, a person suffering from malnutrition may be consuming more than his system can utilize, and more than he would normally consume if the diet were properly constituted. Deficiency diseases result from the absence of some essential elements in the diet. Their occurrence is, therefore, no indication of poverty,[1] and consequent scarcity of food. A dietary conducing to malnutrition may cost more than a well-balanced dietary which promotes health.'[2]

Widespread propaganda on the basis of authoritative investigations ought to be useful in enlightening people as to how better value could be got from properly selected food in terms of physical well-being without involving additional expenditure. The 'eastern drowsiness' and listlessness which characterize the Indian labourer are often largely due to the factor of food, which is not only insufficient but also unbalanced, and it is with the latter aspect that we are just now concerned. About twenty-five years ago investigations into the jail dietaries of Bengal and the United Provinces were made by Col. McCay, which showed that diet is an all-important factor, influencing physical development and the general well-being

[1] Dr Slater calls attention to the fact that 'in some respects the rise in the standard of living has brought physical disadvantage. Thus for example, rice-mills have multiplied, saving housewives the laborious toil—but perhaps healthful exercise—of husking the paddy by pounding; but also robbing the rice of much of its nutritive value, the vitamins in the outermost layer of the grain being removed with the husk by the machinery.'—Introductory note to Pillai, op. cit., p. xiv.

[2] *Agricultural Commission Report*, pp. 494-5.

of the people. He considered that the inferior physique and vigour of the Bengali was most probably due to deficiency of protein in his diet, 'while the inclusion of wheat in gradually increasing proportions as one passes north from Bihar and Orissa and the United Provinces to the Punjab, has led to a marked physical change in the population'.[1] The improvement in communications and transport ought to help in remedying the deficiencies in the diet of a particular province by the importation of the requisite food-stuffs from other provinces. All this, however, assumes a change in the nature of the demand for food-stuffs on the part of the people concerned, and this is a question of education and enlightenment on dietetic matters. Col. McCarrison's researches at Coonoor, and the publicity which they have received at the hands of the Royal Agricultural Commission, have aroused considerable interest in the country on the question of evolving a scientific diet suited to the different climatic conditions in the country and the different occupations pursued by the people. One of the measures suggested by the Agricultural Commission for bringing about an improvement in the general health of the people is the development and conservation of the fish resources of the country—a task in which they invite the Government, Local Boards and the rural community in general to participate in an active manner, since the addition of fish offers the best chance of enriching the diet of a primarily rice-eating people.[2] Large sections of the people have no religious or other objections to the consumption of fish and full advantage should be taken of this fact.

Recently the growing habit of tea-drinking has been causing some uneasiness to dietetic reformers. The habit is especially prevalent in the Presidency of Bombay. There was a time when it was a fashion on the part of writers and reformers even in England to decry what was called 'the vice of tea-drinking', and declamations against 'tea-bibbers' were common.[3] But the working classes there have persisted in its use in spite of all opposition and declamation until tea has become an important item among their necessaries of life. Public opinion with regard to tea-drinking has also taken a

[1] *Agricultural Commission Report*, p. 493.

[2] ibid., pp. 411-17. The Commission also suggest that a Central Institute of Human Nutrition should be established, with which the research, also to be organized by the Provincial Governments, should be co-ordinated. They further recommend a closer collaboration between research on animal nutrition and that on human nutrition, and also between all these investigations in India with similar investigations in other parts of the Empire. 'The problems are so vast that all the staff and material available should be mobilized to assist in their solution.'

[3] Helen Bosanquet, *The Standard of Life*, p. 30.

right-about turn, and tea-sipping instead of being regarded as a vice has now come to be 'a sign of domesticity and temperance'. Tea-drinking is generally advocated as a substitute and remedy for drunkenness. Another novel advocacy of tea is to be found in Dr Slater's *Some South Indian Villages* (p. 232), where he remarks that the Indian peasant is very poor in one particular commodity, which he does not properly appreciate, and that is good drink. 'The great mass of people drink filthy water, water drawn from rivers and irrigation channels and containing every kind of impurity, and from stagnant tanks which are also little better guarded.' Dr Slater believes that 'one of the greatest benefits which could be conferred upon India at the present time would be to popularize the use of tea, the cheapest of all boiled-water drinks'. And he commends the efforts made by the managers of the Buckingham and Carnatic Mills in Madras to popularize tea in the schools, for half-timers and children of mill-hands. But the uses of tea as avoiding the dangers of drinking impure water may be regarded as problematic, because these dangers are not eliminated so long as some water at least continues to be used for drinking purposes not to speak of the evils of tea-drinking itself. The more effective way would be to ensure the supply of pure water. Indeed, as offering an alternative to alcohol, teashops must undoubtedly be regarded as a boon. At the same time there can be no doubt that excessive tea-drinking is harmful to the constitution in a hot climate, specially when inferior brands are used, as in most teashops in India. Some steps seem to be necessary in order to ensure that reasonably good tea is sold in these teashops, instead of the vile decoction generally served, though after all the most effective remedy would be an improvement in the taste of the people themselves. For the rest, we have already admitted that teashops have a distinct role to perform in the task of checking the growing evil of drunkenness and at the same time providing a comparatively harmless stimulant, the need for which, in the case of people who have to undergo exhausting physical labour, cannot be ignored.[1]

[1] Coffee-drinking, which is widespread in South India, gives rise to similar reflections. Expenditure on alcoholic drinks and the policy to be pursued with regard to it will be referred to later (see ch. xi). Other well-known instances of misdirected consumption which will readily occur to the student of Indian Economics are the unduly heavy expenditure on marriages, funerals, and gold and silver ornaments (see ch. x. §61).

CHAPTER V

TRANSPORT

§1. **Importance of transport.**—The importance of transport from the economic, military, administrative, cultural, and social points of view is hardly in need of special emphasis. Throughout the whole history of India difficulties of communication have been a predominant factor in determining political and economic development. These difficulties have been removed in modern times to a certain extent by railway, telegraph, motor, and other forms of transport. But they still constitute a great obstacle to the advance of modern industry. The expenditure involved in equipping the country with an up-to-date system of transport at all adequate to its requirements would be enormous. India is a subcontinent, the distances to be traversed are tremendous and the natural obstacles to be overcome in passing from one region to another are formidable, while even within a restricted area, internal communication often breaks down altogether in the rainy season. Again, India is less fortunate than other countries, like England, in respect of waterways, which historically have played a very important part in facilitating commerce in many countries, especially before the advent of railways.

The means of communication in India were comparatively very defective till as late as the middle of the nineteenth century, and were reminiscent of England in the middle of the eighteenth century, though, owing to the more favourable climatic conditions, the roads were better in India than in England. The railways of course had yet to come, and the few trunk roads constructed by Indian rulers, especially in northern India by the Moguls, were thoroughly inadequate even for the very moderate needs of the country in those days.[1] Many of the so-called roads were mere tracks cut by village carts across the face of the country, and wheeled traffic was for the most part impossible during the rainy season. Pack animals led by caravans or *labans* were the only means of access to many parts of the interior. Moreover, the roads were unsafe, being infested by highwaymen like the Thugs and the Pindharis. There were no navigable canals to speak of, though a few regions such as those along the Ganges and the Indus—which were then great natural highways of commerce—and the coastal districts were

[1] See W. H. Moreland, *India at the Death of Akbar*, pp. 166-7.

more fortunately situated in this respect than others. On the whole, the state of communications in northern India with its vast plains easily traversable in the dry season, its navigable rivers and a few 'made' roads, was much more satisfactory than in the peninsula with its rugged mountainous territory and poor facilities for water transport except on the two coasts.

We have already discussed the economic and social effects of the imperfect means of communication and dwelt on the isolation and the self-sufficiency of the village and the prevalence of local economy with all its attendant handicaps in respect of markets and division of labour; the immobility of labour and the conservatism of the people; and the violent dislocation of the otherwise smooth routine of economic life in times of scarcity and famine.[1] A veritable economic and social revolution has, however, been wrought by the modern improvements in communication and transport dating from the time of Lord Dalhousie, who initiated a vigorous public works policy. In this chapter we shall give a short account of the various efforts made in this connexion.

We may for the sake of convenient treatment divide the subject into its three main sub-divisions: (i) railways—at present the most important part of India's system of communications; (ii) roads; and (iii) waterways.[2]

RAILWAYS

§2. **Diversity of relations between the State and the railways.**[3]— A special feature of the Indian railway system is the diversity of relations between the State and the railways in respect of ownership and control. Of the important lines situated in British India, or in which the Government of India are interested, four are owned and worked by the State (the North-Western Railway, Eastern Bengal Railway, East Indian Railway, with which has been amalgamated the Oudh and Rohilkund Railway from 1 July 1929, and the Great Indian Peninsula Railway[4]; five are owned by the State but worked on its behalf by companies enjoying a guarantee of interest from the Government (the Bombay, Baroda and Central India, Madras and Southern Mahratta, Assam-Bengal, Bengal-Nagpur, and South Indian railways); two important lines

[1] See vol. I, ch. v.

[2] In recent years air transport has assumed a new importance and bids fair to further revolutionize the transport economy of the country.

[3] See *Report on Indian Railways* (1936-7), vol. I, Appendix B.

[4] The Burma Railways were separated from the Indian State Railways with effect from 1 April 1937 following the separation of Burma from British India.

(the Bengal and North-Western and Rohilkund and Kumaon) and many others of less importance are the property of private companies, some being worked by the owning companies, some by the State or by the companies that work State-owned systems; several minor lines are the property of the District Boards or enjoy a guarantee of interest granted by such Boards. There are also certain Indian State lines like the H. E. H. The Nizam's State Railway (which before 1930 was the property of a company and was known as the Nizam's Guaranteed State Railway). Of the total route mileage of Indian railways amounting to 43,128 miles on 31 March 1937, the State owned 31,729 miles or about 74 per cent, and directly managed 19,142 miles or about 44 per cent of the total mileage open at the end of the year.

§3. **Main periods of railway history.**—It is necessary to review the history of Indian railways and the many changes in Government railway policy in the course of it, in order to understand this perplexing diversity of conditions in regard to the agency by which the railways are managed and of the relations of the Government with the various classes of companies.

Six more or less well-defined periods in the history of Indian railways may be distinguished: (i) 1844-69: the old guarantee system; (ii) 1869-79: State construction and management; (iii) 1879-1900: the new guarantee system; (iv) 1900-14: rapid extension and development, and commencement of railway profits; (v) 1914-21: breakdown of the railway system under the stress of War conditions; and (vi) 1921 onwards: the Acworth Committee and the overhauling of railway policy on the basis of direct management and control by the State.

§4. **The old guarantee system (1844-69).**—The first proposals for the construction of railways were made in 1844 and contemplated the construction of lines by railway companies incorporated in England and enjoying a guarantee by the East India Company of a specified return. Accordingly, contracts were made for the construction of two small railway lines near Calcutta and Bombay with the East Indian Railway Company and the Great Indian Peninsula Railway Company respectively. But the plan of entrusting the construction and management of Indian railways to guaranteed companies did not come to be generally adopted till after 1854. It was Lord Dalhousie's famous Minute on the subject in 1853, that gave a decisive turn to the Government policy in this direction. In this Minute, Lord Dalhousie urged the creation of a system of trunk lines connecting the interior of each Presidency with its principal port and connecting the different Presidencies with one another. He referred in the following terms

to the benefits which he expected from railways both to India and England: 'Great tracts are teeming with produce they cannot dispose of. Others are scantily bearing what they would carry in abundance if only it could be conveyed whither it is needed. England is calling aloud for the cotton which India does already produce in some degree, and would produce sufficient in quality and plentiful in quantity if only there were provided the fitting means of conveyance for it from distant plains to the several ports adapted for its shipment. Every increase of facilities for trade has been attended, as we have seen, with an increased demand for articles of European produce in the most distant markets of India. Ships from every part of the world crowd our ports in search of produce which we have or could obtain in the interior, but which at present we cannot profitably fetch to them, and new markets are opening to us on this side of the globe under circumstances which defy the foresight of the wisest to estimate their probable value or calculate their future extent.' He explained his reasons for preferring the agency of companies, under the supervision and control of the Government, to direct construction by the Government. Not that he had any doubts regarding the capacity of State engineers, but he thought that the conduct of commercial undertakings did not fall within the proper functions of the Government, especially in India, where it was necessary to discourage the people's habit of dependence on the Government for everything. One of the results which Lord Dalhousie contemplated with satisfaction from rapid railway construction by British companies was a more extensive employment of English capital and enterprise in Indian trade and manufactures.

In accordance with Dalhousie's plan, contracts were entered into with eight companies between 1854 and 1860 for constructing and managing railways in different parts of India. A fresh stimulus to railway construction was given by the experience during the Mutiny period, when movements of troops and material were seriously impeded owing to defective transport. The main features of the contracts with the early guaranteed companies were as follows:—(i) free grant of land; (ii) a guaranteed rate of interest, ranging from $4\frac{1}{2}$ to 5 per cent and payable at *22d.* per rupee; (iii) utilization of half the surplus profits earned by the companies to repay the Government any sums by which they might have had previously to make good the guarantee of interest, the remainder belonging to the shareholders; (iv) reservation of certain powers of supervision and control by the Government in practically all matters of importance except the choice of staff; and (v) option to the Government to purchase the lines after twenty-five or fifty

years on terms calculated to be the equivalent of the companies' interest therein.

This system, however, proved to be a great drain on the resources of the State and a burden on the taxpayer in India. For the companies were unable to earn their five per cent and called upon the Government to make good the deficiency. The deficit in the railway budget amounted to Rs. 1,66,50,000 by 1869. This was attributed by several critics like Lord Lawrence, who in his Minute in 1867 had strongly condemned the guarantee system, to the extravagance of the companies who had no incentive for economy of construction under the guarantee system.[1] The Acworth Railway Committee, however, have expressed the opinion that the formation of English-domiciled companies was the only wise course for the time, in view of the urgent need for railways in India, and the shyness of Indian capital making it necessary to offer special attractions to British capital for this purpose. However, others have questioned the wisdom of this policy and denied that English capital could have been attracted only by the inducement of a guaranteed rate of profits. For example, it was put in evidence before the Parliamentary Committee of 1872 by William Thornton that unguaranteed capital would have gone into India for the construction of railways, had it not been for the guarantee. England had an immense amount of capital which had no scope for remunerative investment at home, and which, therefore, was seeking outlets in South America and other countries, and it was not conceivable that it would persistently have neglected India.[2] It also remains an unproven assumption that the rate of interest that was actually guaranteed was in point of fact necessary. There are good grounds for believing that British capital and enterprise could have been tapped by the offer of an appreciably lower rate, having regard to the then prevailing easy conditions of borrowing in the English money-market. This contention is strengthened by the later experience of the Government when they were, without much difficulty, able to enter into contracts under the revised guarantee system on terms much less favourable to the companies in respect of the guaranteed rate of interest and other concessions. Apart from the loss to the country due to unnecessarily liberal terms granted to the companies, we may also point out that while the Government showed their active interest in the promotion of railways, they did not exert themselves to build up any of the industries required to supply the materials demanded by the railways and this made them all the more expensive.

[1] See R. Dutt, *The Economic History of India in the Victorian Age*, pp. 355-6.

[2] ibid., p. 390.

§5. **State construction and management (1869-79).**—Being dissatisfied with the financial results of the old guarantee system, the Government made an unsuccessful attempt during 1862-4 to secure the construction of railways in India on terms more favourable to themselves than those in the contracts with the original companies. An annual subsidy at a certain rate per mile of line, instead of a guarantee, was granted to a few companies, like the Indian Branch Railway Company, which later changed its name to the Oudh and Rohilkund Company. The Government of India were not prepared to continue the old guarantee system, their objections being the extravagance of the companies, the absence of effective Government control over them, the inconvenience to the Government of a guaranteed rate of interest on the capital of the companies, and the remoteness of the prospect of securing a share of the surplus profits to themselves. Two important changes were consequently made. In the case of some of the more important railway companies, like the Great Indian Peninsula, the arrangements regarding the distribution of surplus profits were altered so as to enable the Government to claim half the surplus profits for each half-year unconditionally, the Government relinquishing their right to purchase the lines at the end of the first twenty-five years from the dates of the respective contracts. An even more important change in policy—remarkable for the sixties when laissez-faire ideas held the field—occurred when the Secretary of State decided that, so far as capital for new lines in India was concerned, the State should secure for itself the full benefit of its own credit and of the cheaper methods of construction, etc. which it was expected it would be able to use. Accordingly, for several years after 1869, the capital expenditure was chiefly incurred direct by the Government, and no fresh contracts with guaranteed companies were made. It was decided to borrow annually amounts up to two million pounds for constructing lines to be managed by the State, and a new cheaper gauge, namely the metre gauge, was adopted. A vigorous programme of railway construction then followed with satisfactory results so far as the costs were concerned. But the main difficulty was in respect of continuous and adequate provision of funds. In the first place, the Sind and the Punjab lines (later known as the North-Western) had to be converted from metre to broad gauge for strategic reasons. In the second place, the financial difficulties of the Government were increased by the inroads which the falling rupee was making on the exchequer, and also by the famines between 1874 and 1879. These difficulties were aggravated by the Frontier War with Afghanistan. Moreover, the Famine Commission of 1880 held that 5,000 additional miles of railway were urgently

needed and that the country could not be held safe from famines until the Indian railway mileage had aggregated to 20,000. The Government were thus forced to the conclusion that the State alone could not find sufficient funds for pushing ahead with railway construction as fast as the Famine Commission recommended, and decided again to take the help of capital borrowed by private companies, especially because it was then thought that a limit was necessary to the capital borrowed annually by the Government.

§6. **The new guarantee system (1879-1900).**—Thus by the early eighties the current of thought in favour of State management had spent its main force, and a new period in railway history was ushered in when the Government decided again to utilize the agency of guaranteed companies with certain modifications of the old terms as recommended by the Famine Commission, and contracts were made with the new guaranteed companies, such as the Bengal-Nagpur, and the Madras and Southern Mahratta railway companies. The chief differentiating features of the new guarantee system were as follows:—(i) the lines constructed by the companies were declared to be the property of the Secretary of State for India, who had the right to determine the contracts at the end of approximately twenty-five years after their respective dates, or at subsequent intervals of ten years, on repaying at par the capital provided by the companies; (ii) interest was guaranteed on the capital raised by the companies at a lower rate, the most usual rate being $3\frac{1}{2}$ per cent; (iii) the Government retained a much larger share (usually three-fifths) of the surplus profits for their own benefit.

Thus the lines constructed under the new system by the companies were from the beginning the property of the Government, though the companies were given a certain guaranteed rate of interest on the portion of the capital raised by them and were allowed to manage the lines when completed.

Similarly, when the contracts with the old guarantee companies expired, the Government in most cases exercised their right of terminating them, though the method of making use of this right differed in different cases. In some cases, for example the Eastern Bengal, the Oudh and Rohilkund and the Sind-Punjab railways, the lines were purchased and transferred to State management. In other cases, like the East Indian and the Great Indian Peninsula, the lines were acquired by the State, but were handed over again for management to the same companies under revised contracts. So also, when the contracts with the new guarantee companies expired, though arrangements were made for the continuance of management by the original companies, the Government secured more favourable financial conditions by various methods, such as

reduction in the companies' share of capital and in the rate of interest guaranteed, and further modification of the clauses relating to the division of surplus profits.

§7. **The present position.**—The existing arrangements between the Government and the guaranteed companies may be conveniently summed up at this stage. The State has now come to be the owner of the bulk of the trunk lines. The greater part of the capital has become its property, either through having been originally supplied by it or through the acquisition by the Government of the companies' interests on the termination of the old contracts. The capital originally contributed by the companies has thus come to be only a small proportion of the total cost of the existing system. When funds are required for further capital expenditure the Government have the option of either themselves providing them or of calling on the companies to do so. The management of the railways, except in a few cases,[1] has been left to the companies, though they are subject to Government control, exercised, since 1905, through the Railway Board created in that year, with regard to matters like the standard of repairs, rolling stock, public safety, co-ordination of the railway systems, train services, rates and fares, etc. The Government have also the power of appointing a Government Director to the boards of the companies. All these contracts (except one fixed for a term of twenty-five years) are terminable at the option of the Secretary of State at specified dates on payment of the companies' capital at par. The last of these contracts to expire will be the one with the Bengal-Nagpur Railway, which terminates in 1950.

§8. **Branch line companies.**—Other types of railway companies also came into existence in this period. Indian States were invited to undertake railway construction in their own territories, and Hyderabad State was the first to do so, by extending a guarantee to the State railway formed for the purpose. In this way nearly 5,000 miles have been constructed by Indian States who own the bulk of these lines. An attempt was also made to encourage the construction of feeder lines by branch line companies, who were offered, in 1893, rebates on gross earnings of the traffic interchanged with the main lines, so that the dividend might rise to four per cent. These rebate terms being found unattractive had to be revised from time to time so as to provide for an absolute guarantee, with a share of surplus profits or a more favourable rebate, so as to meet the requirements of the market. Under these terms a number of branch line companies were formed. But on the whole, this system has

[1] The recent transfer of some of the railways to State management marks the beginning of a new policy to be described later.

not worked well financially, and was adversely criticized by the Acworth Committee, who described it as a fifth wheel in the coach. While admitting that it enabled lines to be built which otherwise could not have been built, the Committee recommended that the Government should abandon the old policy by reducing the number of the existing branch line companies by amalgamation, and should undertake the construction of such lines themselves, except when they could not or would not provide adequate funds—a contingency which did not then seem likely. In conformity with these recommendations the Government decided in 1925 to find the necessary capital themselves for the construction of branch and feeder lines. They have also expressed their willingness to construct such lines for purely local or administrative convenience upon a guarantee to the Railway Board against loss by the Local Government or local authorities concerned.

§9. **Rapid extension and development of railways and commencement of railway profits, 1900-14.**—The main features of this period were the rapid development of railways as part of a new and much more vigorous policy of national development affecting almost every branch of economic life. The railways attained to the dignity of a separate department in 1905, when the Railway Branch of the Public Works Department was abolished, and a Railway Board consisting of a president and two members was established at the head of the railway system under the Department of Commerce and Industry. A fresh impetus was given in 1908, when the Mackay Committee on Railway Finance laid down for the future a standard of £12,500,000 as the annual programme for capital expenditure on railways, though it was to be subject to periodical revision. Although the Government were neither able to attain the standard recommended by the Mackay Committee nor allowed to adhere over a series of years to any uniform rate, they spent sums considerably larger than had been the case in previous years. The railway mileage in this period increased from 24,752 in 1900 to 34,656 in 1913-14, and the capital outlay, from Rs. 329·53 crores to Rs. 495·09 crores.

Another notable characteristic of this period was the commencement of railway profits in 1900. The unprofitable character of railways approximately till that date was due to uneconomical construction and management by the old guarantee companies, the construction of unremunerative strategic lines, like the North-Western Railway, and those constructed for the purpose of famine relief, and the absence of traffic to make a success of this new means of transport, which could not at once quite fit in with the existing economic organization of the country. The losses to the

State during the first forty years of the existence of the railways amounted to Rs. 58 crores. After that the railways began to yield a net return to the State on the capital outlay at charge, thanks to the general economic development of the country, and especially of the Punjab and Sind under their irrigation works—which have enabled even the Frontier Railway, for a long time regarded as the Cinderella of Indian railways, to pay its way—and the renewal of the original contracts with the guaranteed companies under terms more favourable to the Government. The gain to the State was small for the first ten years after 1900, but by 1924 the total gain had aggregated to Rs. 103 crores. Railway profits, however, are subject to remarkable variation from year to year, depending as they do on the agricultural position and the course of the internal and external trade of the country. The adoption of the recommendations of the Acworth Committee, and the retrenchment carried out as suggested by the Inchcape Committee (1922-3), placed Indian railways in a sounder financial position than before. On the capital at charge of the State, the gross profits (gross receipts minus working expenses) have varied as follows during recent years.

Year	Percentage	Year	Percentage
1913-14	5·01	1928-9	5·22
1916-17	6·46	1929-30	4·65
1918-19	7·53	1930-1	3·46[1]
1921-2	2·64	1931-2	3·0
1922-3	4·38	1932-3	2·9
1923-4	5·24	1933-4	3·1
1924-5	5·85	1934-5	3·4
1925-6	5·31	1935-6	3·5
1926-7	4·95	1936-7	4·1
1927-8	5·3		

The Retrenchment Committee laid down that a five and a half per cent net return on the capital outlay should be aimed at by the railways. Regarding the railway profits declared by the Government, Mr Chandrika Prasad observes: 'In declaring surplus profits on the railways, especially during recent years, the ordinary commercial principle of allowing for depreciation on stock has not been applied.' He contends that the profits declared must be subjected to considerable discount on this account. This position

[1] Owing mainly to the adverse effects of the trade depression the railways sustained heavy net losses after paying interest charges from 1930-1 to 1936-7 (both years inclusive). For further particulars see §15 below.

was upheld by the Acworth Committee, who strongly recommended that each railway should make adequate provision annually for the maintenance and the renewal of its permanent way and rolling stock. The question of the financial results of the working of railways is further dealt with in §§14-17 below.

§10. **Breakdown of the railway system (1914-21).**—This period is characterized by the utter breakdown and rapid deterioration of the railways, partly because of the strain to which they were subjected by the necessity of having to provide for the large movements of troops and materials at a time when a part of the rolling stock, staff, etc. was required for the construction and working of the military railways in Mesopotamia and other theatres of war, and partly because of the general financial embarrassment of the Government, who were compelled seriously to curtail the annual programme of capital expenditure on railways. To add to all this, it was extremely difficult to obtain any railway material from England during this period. Not only had the fresh extension of railways to be practically held up but even the existing lines could not be maintained in good condition. The Acworth Committee give in the following terms a picture of the breakdown of the railway system under the stress of War conditions: 'There are scores of bridges with girders unfit to carry train loads up to modern requirements; there are many miles of rails, hundreds of engines, and thousands of wagons, whose rightful date for renewal is long overpast.' It is no matter for surprise, therefore, that loud complaints were made by the public and the trading community about the great inconvenience to passenger and goods traffic. Public opinion was becoming steadily hostile to the management of the bulk of the State railways by English domiciled companies and demanded that the State should take over the management wherever possible.

§11. **The Acworth Committee and after.**—It was also being increasingly realized that the Railway Board, as it was constituted, was not able to take the initiative in laying down railway policy and failed to exercise effective control over the railway administration, especially in regard to fares and rates, being overloaded with routine, trammelled by unnecessary restrictions and handicapped by its ignorance of local conditions and inadequate provision for technical and inspecting staff. So also the need for a fresh lead was felt in respect of the future policy of railway finance. All these questions were, therefore, referred to a special committee appointed in November 1920, and presided over by a railway expert from England, the late Sir William Acworth. The immediate cause of the appointment of the committee, however, was the question as

to the action to be taken in connexion with the East Indian Railway, State-owned but managed by the East Indian Railway Company, whose contract with the Government was terminable in December 1919. As a temporary measure the old contract was extended to the end of 1924, and the general questions arising out of the discussion regarding the respective merits and demerits of various possible systems of management were referred to the Acworth Committee. After a comprehensive inquiry the Committee issued their Report in the following year, embodying their findings on several questions of importance which we shall now proceed to review. We shall, however, first deal with the State versus company management controversy.

§12. **Case for State management in India.**—On theoretical grounds the case against railway management by the State may be conceded to be overwhelmingly strong.[1] But when we come to consider, with reference to any particular country, whether it ought to adopt company or State management, simple appeal to theory is of little use. Actually, historical causes rather than theoretical considerations have determined any particular system in operation, and different countries are prospering more or less under different systems. In India, the presumption is in favour of the Continental principle that whatever can be done by the Government should be thus done, rather than the Anglo-Saxon principle, that whatever can be done without the Government should be thus done. The Government undertake railway business for various reasons, either political, or in order to make up for the lack of private enterprise, or again, in order to secure for the people cheaper rates, better facilities and more impartial treatment of the various interests. All these reasons have been more or less powerful in India in strengthening the case for State management. Moreover, company management in the true sense of the word is impracticable in this country, and, therefore, as the Majority Report of the Acworth Committee points out, the whole reference to foreign countries and the relatively greater success achieved by company management elsewhere is irrelevant. State ownership already exists for the most part in this country and also direct State management to some extent, as in the case of the North-Western Railway and Eastern Bengal Railway, to which have been added recently the East Indian (1924), the Great Indian Peninsula (1925) and the Burma Railways (1929). Most of the State-owned railways were, however, managed until lately by companies with a London domicile, and even today nearly forty per cent of the State-owned railways are

[1] Consult on this subject W. M. Acworth, *State Railway Ownership*.

managed by companies. But the opinion that the management of all the railways should be taken over by the State is gaining steadily in strength and vehemence. It has been supported by the Majority of the Acworth Committee and non-official Indian public opinion generally. There is a general consensus of opinion that, in any case, management by companies, at least in the present form—that is to say, by companies with a London domicile—has got to go. The Acworth Committee, however, were divided as to whether the alternative should be State management, or management by companies with an Indian domicile. The majority, headed by Sir William Acworth the Chairman, pronounced definitely in favour of the former alternative. The case for State management in India may be put as follows.[1]

Though a company investing its own money, managing its own property and judging its officials by their success in producing results in the shape of dividends usually conducts business with more enterprise, economy and flexibility than are common in businesses directly managed by the State, the English companies managing State Railways in India have long ceased to be companies in this sense. The property entrusted to their management is not their own and their financial stake in it is comparatively very small.[2] Such a system has never worked satisfactorily in the past and cannot be made to do so in the future. The management is only nominally entrusted to the companies, for the Government, feeling themselves to be the real owners, have left really no initiative in the hands of the companies. The Government Director sitting on the home board has the power of vetoing any decision of his colleagues. The railway receipts are required to be paid in their entirety into the Government treasury, and money required for revenue expenditure can be drawn only subject to restrictions prescribed by the Government and not necessarily to the extent desired by the company. Important matters like the creation of appointments, etc. are largely controlled by the Government. Thus the companies cannot and do

[1] cf. *Acworth Committee Report*, pars. 210-39.

[2] In this connexion, the following figures will be found interesting. The total capital outlay at charge on all railways, including those under construction, amounted to Rs. 880·13 crores at the end of March 1937. Out of this, Rs. 789·03 crores was capital at charge on State-owned railways, including premia paid in the purchase of companies' lines. The remainder, Rs. 91·10 crores, represented capital raised by Indian States, companies and District Boards. By far the greater portion of this amount, namely Rs. 751·63 crores, is Government capital and only one-twentieth, or Rs. 37·39 crores, is owned by companies. The figures include Rs. 33·80 crores on account of capital expenditure to the end of March 1937 on strategic lines. See *Report on Indian Railways* (1936-7), vol. I, par. 35.

not manage the undertaking, and cannot break new ground in any direction except with the sanction of the Government. The Government do not feel an obligation to take any initiative themselves. Nor can they stir up the companies, if the latter are supine. In short, it is a system under which a progressive company is hampered by meticulous Government control over every detail of expenditure, and under which, on the other hand, the utmost wisdom on the part of the Government is not able to prevent injuries caused by the unwise and unprogressive policy of a company's board, both to the revenues of the State and the economic development of the country. As regards the proposal put forward by the Minority, that the management should be transferred from English to Indian companies, the first objection is that the Indian companies would have only a minority interest in the undertaking. The State would remain the predominant partner, appoint one-half of the directors and nominate the Chairman and so retain its control. The division of responsibility between the Government and the Board of Directors would still continue, and the executive officers, with a divided allegiance to a Board of Directors which appointed and paid them, and to the Government which stood behind the directors, could not do the best work of which they were capable. Competent business men would refuse to join the Board if they found their power limited by Government control and Government regulations, and this seems inevitable under the plan advocated by the Minority. Since it is not proposed that private companies should buy the railways out and out from the Government, as this would involve raising capital amounting to crores of rupees, the financial interest of the companies, as they are proposed to be constituted by the Minority, is bound to be small. A mere change in the domicile of the company, therefore, would not improve matters, as companies substantially independent of Government cannot be formed in India, and without such independence the advantages of private enterprise could not be gained. Indian domiciled companies, again, would not be able to be of much assistance in raising the necessary funds for railway construction. The Government would always have to take the larger share of this work on themselves, and they would find this task much easier under a system of State management than under company management. Company management, whatever the domicile, would be unpopular in India. From the financial, economic and political point of view money required for Indian railways should henceforward be raised in India itself as far as possible and these loans will be more readily subscribed to by the public if the Government themselves take over the management of the railways. Again, if resort to external

loans is necessary, the credit of the Government of India and the Secretary of State as the greatest bankers of the country is an asset of inestimable value. One of the most important arguments in favour of State management in this country is the generally accepted view that company management has shown itself wilfully negligent of national interests, whether by the manipulation of routes and rates for the benefit of European interests and to the detriment of Indian manufactures and Indian commerce, or by refusing a fair field to Indian talent in the railway services, especially in the higher grades. These evils would have a greater chance of being remedied under State management. Another advantage expected from State management is the economy in the expenses of working the railways. At present the State has to pay not only interest on the company's share of the capital but a share in the profits as well, which under State management would accrue to the Government treasury instead of going to absentee companies in London, or to private companies with an Indian domicile, supposing such were started. There does not seem to be any reason to fear that State management in this country is likely to be less efficient and therefore less profitable than such company management as can be thought of in the present circumstances. In so far as actual experience of State management in India is any indication at all, it has shown that it does not in any way compare unfavourably with company management. Nor does there seem to be any truth in the contention that such success as has been achieved by State management in India is due to the existence side by side of railways worked by companies and to the healthy emulation caused thereby. A serious disadvantage of the present system comes from the fact that the vested interests of the railways in the different parts of the country control, not merely the carriage of goods and passengers, but also the construction of new lines, trunk or feeder, and the connexions of two or more different lines. Spheres of influence have come into existence and form an obstacle in the way of proper railway development. Under State management this evil would be avoided, and lines would be constructed as demanded by the real interests of the country. Again, under State management, the convenience of traders and passengers would be much better attended to than is the case at present.[1] The companies have been charged with making the maximum amount of profits their sole object, and there is great dissatisfaction in India on account of their alleged neglect of trade

[1] As Mr N. B. Mehta points out, the lack of inter-railway competition and of a vigilant public opinion has made State control almost a moral obligation in India. See *Indian Railways : Rates and Regulations*, p. 81.

interests and the interests of passengers, more particularly of the third-class passengers. The grievances of the public have a much greater chance of being speedily and effectively redressed under State management. The boards of the railway companies situated in London have been generally insensible to such representations from Indian interests as happen to reach them. On the other hand, European merchants being better organized and better represented in England can make their voice more easily heard. Such a state of things cannot be regarded as conducive to the rapid development of our commerce and industry. Apart from racial prepossessions, control exercised from a distance of 6,000 miles is bound to be highly inconvenient, because it unduly fetters the railway executive on the spot.

Point was lent to this controversy when the contracts with the Great Indian Peninsula and East Indian Railways were due to expire in 1924-5. In February 1923, the matter came up before the Assembly. The feeling of Indian non-official members was decidedly in favour of whole-hearted State management, with the consequence that the simple motion for taking these two railways under State management was passed. They were accordingly taken over by the Government for direct management. The Burma Railways also passed under State management from January 1929. Reference has already been made to the purchase of the Southern Punjab Railway by the State in 1930. It is worked by the North-Western, a State-owned and State-managed railway. In view of the strength of public opinion and its unmistakable preference for State management, the probabilities are that all the railways in course of time will come under Government management.[1]

§13. **Separation of railway finance from general finance.**—One of the recent changes of outstanding importance vitally affecting the efficiency of railways is the separation of railway finance from general finance. The Acworth Committee urged the adoption of this step on various grounds. In the first place it would remove the element of uncertainty in the annual Budget estimates due to the inclusion therein of railway profits. These vary according to the character of the season and trade conditions, with the result that the estimates might be out by several crores of rupees. The case for separation was seen to be even stronger from the railway standpoint. The dependence of the railways on the exigencies of

[1] It is unfortunate, however, that the Government did not exercise the option to determine the contracts on 31 December 1937 with the Madras and Southern Mahratta, Bengal and North-Western, and Rohilkhund and Kumaon Railways.

the General Budget and the financial position of the country prevents them from being run on a commercial basis. The arrangement which assumed that the railway concern goes out of business on 31 March every year and begins life afresh at the beginning of each official year was obviously detrimental to the railways. The separation of the two budgets was calculated not only to enable the railways to be conducted as a business undertaking, but also to free the Government from the many difficulties and uncertainties of the old system. In view of the importance of the subject a resolution was brought before the Legislative Assembly in September 1921, when a Joint Committee of the two houses was appointed to investigate the question. The committee declared immediate separation to be outside practical politics. They were, however, impressed with the necessity of rehabilitating the existing railway lines, which had been utterly neglected during the War period, and recommended a guaranteed programme of Rs. 150 crores to be distributed over a period of five years and to be spent upon the improvement and completion of the existing lines, and provision of better amenities for third-class passengers. The Assembly endorsed this recommendation and it was also induced to accept the scheme for separating railway finances from general finances on the condition of ensuring to the latter a definite ascertainable annual contribution from railways, which was to be the first charge on their net receipts. This contribution was settled upon the basis of one per cent on the capital at charge of commercial lines, excluding capital contributed by companies and Indian States, at the end of the penultimate financial year, plus one-fifth of the surplus profits in that year, interest on capital at charge of strategic lines and loss in working being deducted. The Legislative Assembly stipulated that if, after payment of the contribution so fixed, the amount available for transfer to the Railway Reserve should exceed Rs. 3 crores, one-third of the excess should be paid to the general revenues. This Railway Reserve was to be used to secure the payment of the annual contribution, to provide, if necessary, for arrears of depreciation and for writing down capital, and generally to strengthen the financial position of the railways. It was expected that by this arrangement the Indian taxpayer would be assured of a regular contribution in relief of taxation from his investments in railways, while the task of maintaining a continuous financial policy and of distinguishing between a temporary and permanent surplus or deficit in accounts would be immensely facilitated. The first separate railway budget under this scheme was presented to the Assembly in March 1925. (The financial results of the Separation Convention are reviewed in §15 below.)

§14. **Railway Budget.**—The subjoined table gives the principal heads of revenue and expenditure included in the Railway Budget.

RAILWAY BUDGET FOR 1937-8[1]

In crores of rupees

HEADS OF REVENUE		HEADS OF EXPENDITURE	
(A) *State Railways*—		(A) *State Railways*—	
(*a*) Commercial Lines—		(*a*) Commercial Lines—	
Gross Receipts ...	94·65[2]	Interest—	
Deduct—		On Government capital at charge	26·85
Working expenses of State Railways	61·89[3]	On capital contributed by Indian States and Companies	1·18
Surplus profits paid to Indian States and Railway Companies	0·39	Total interest, commercial lines	28·03
Payments to worked lines ...	2·88	(*b*) Strategic Lines—	
Net Receipts ...	29·49	Interest on Capital at charge	1·33
(*b*) Strategic Lines—		Total Interest ...	29·36
Gross Receipts ...	1·45	(B) *Subsidized Companies*—	
Deduct—		Land and subsidy ...	0·07
Working expenses ..	2·06	(C) Miscellaneous Railway Expenditure	0·56
Net Receipts ...	−0·61	(D) Payments to General Revenues—Contribution[4] ...	0·15
Total Receipts, Commercial and Strategic Lines	28 88	Repayment of loan to Railway Depreciation Fund ...	...
(B) *Subsidized Companies*—		Surplus Railway Revenue transferred to Railway Reserve Fund	...
Government's share of surplus profits ..	0·14		
(C) Miscellaneous Railway Receipts—			
Interest on Depreciation and Reserve Fund balances ...	0·72		
Dividend on investments in branch lines and other miscellaneous receipts	0·31		
Interest on Depreciation Fund balances ...	0·09		
Total Receipts ...	30·14		
(D) Withdrawal of sums deposited on account of Railway Depreciation Fund ...	...		
Total ...	30·14	Total ...	30·14

[1] See *Central Budget for 1937-8*, pp. 34-5.

[2] Includes Rs. 5·35 crores earnings of worked lines.

[3] Includes Rs. 2·61 crores working expenses of worked lines.

[4] See note on p. 186.

§15. **Financial results of the railways.**—The financial results of the working of railways with which the Government of India is directly concerned for the period from 1924-5 to 1937-8 are given in the table on page 187, and serve to illustrate the financial working of the Separation Convention of 1924. Taking the first twelve years of this period (1924-5 to 1935-6) it is found that the first six years were years of prosperity and the last six were years of adversity. Taking the period as a whole the total surplus revenue earned in the first six years amounted to Rs. 52,64 lakhs, whilst in the second six years the deficiency amounted to Rs. 41,63 lakhs. During this long period of varying fortune there was a net surplus of Rs. 11,01 lakhs or rather less than one crore of rupees per annum after meeting working expenses, providing for depreciation and paying interest in full on borrowed capital.[1]

The total contributions to the general revenues during the period of prosperity, 1924-5 to 1929-30, amounted to Rs. 42 crores, or an average of Rs. 3 crores for the whole period dating from the Separation Convention. During the same period a balance of Rs. 41½ crores was accumulated in the Depreciation Fund. The fortunes of the railways underwent a radical change for the worse and rot set in after the year 1930-1. That year ushered in an era of deficits which were mainly the result of the adverse effects of world depression and the drop in commodity prices, dwindling of wheat exports, the disturbed condition of India in recent years,

(*Footnote continued from* p. 185)

[4] Contribution due from Railway to General Revenues in 1937-8 (Based on actuals of 1935-6).

	(In thousands of rupees)
(1) One per cent on capital of Rs. 7,16,03,05 at charge, commercial lines	7,16,03
(2) One-fifth of surplus (receipts *minus* charges such as working expenses, interest payments, land and subsidy, etc., and contribution at one per cent on the capital at charge)	
Total contribution from railway revenues ...	7,16,03
(3) *Deduct*—Loss on strategic lines borne by railway revenues: (i) Interest on capital = Rs. 1,37,52 + (ii) Loss in working = Rs. 65,27 + (iii) Interest on the amount of loss in working met from Depreciation Reserve Fund of commercial lines = Rs. 44,93 ...	2,47,71
Net payment due from railways to general revenues ...	4,38,32

See *Railway Budget for 1937-8*, p. 37.

[1] *Railway Member's Budget Speech*, Central Budget for 1935-6, par. 17.

REVIEW OF FINANCIAL RESULTS FROM 1924-5 TO 1937-8 [1]
(COMMERCIAL AND STRATEGIC LINES TOGETHER)
Figures in lakhs of rupees

	1924-5	1925-6	1926-7	1927-8	1928-9	1929-30	1930-1	1931-2	1932-3	1933-4	1934-5	1935-6	1936-7 Revised Estimate	1937-8 Budget Estimate [2]
Mileage { State-owned	27,002	27,090	27,664	28,086	29,111	30,878	31,197	31,642	31,644	31,619	31,619	31,732	31,732	29,724
Mileage { Worked lines	5,847	5,977	5,815	5,812	5,843	4,733	4,873	4,866	4,613	4,634	4,634	4,578	4,397	4,084
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Gross traffic receipts { State-owned	1,00,13	98,94	98,42	1,03,43	1,03,73	1,02,70	95,10	86,63	84,43	86,63	90,20	90,65	95,00	90,75
Gross traffic receipts { Worked lines	7,34	7,12	6,77	7,18	7,27	6,47	4,99	5,07	4,86	5,13	5,28	5,37	5,45	5,35
Operating expenses { State-owned	51,65	52,99	52,89	53,06	54,22	55,59	54,39	49,31	49.08	49,50	50,27	50,87	50,75	48,75
Operating expenses { Worked lines	3,70	3,57	3,33	3,53	3,63	3,30	2,66	2,63	2,49	2,60	2,66	2,68	2,64	2,61
Depreciation Fund ...	10,35	10,67	10,89	11,38	12,00	12,59	13,07	13,46	13.77	13,56	13,72	13,25	13,15	12,59
Payments to worked lines ...	3,64	3,55	3,44	3,65	3,64	3,17	2,33	2,44	2,37	2,53	2,62	2,69	2,81	2,74
Net traffic receipts (State lines)	38,13	35,28	34,64	38,99	37,51	34,52	27,64	23,86	21,58	23,57	26,21	26,53	31,10	29,41
Net miscellaneous receipts after deducting miscellaneous charges and surplus profits payable to Companies	−1,07	−1,19	−1,27	−87	−37	−2	−11	1	1,10	1,05	53	87	−12	10
Net revenue	37,06	34,09	33,37	38,12	37,14	34,50	27,53	23,87	22,68	24,62	26,74	27,40	30,98	29,51
Interest charges	23,90	24,81	25,87	27,27	29,33	30,46	32,72	33,07	32,91	32,58	31,80	31,39	30,83	29,36
Surplus	13,16	9,28	7,50	10,85	7,81	4,04	−5,19	−9,20	−10,23	−7,96	−5,06	−3,99	15	15
Paid as contribution to general revenue	6,78	5,49	6,01	6,28	5,23	6,12	5,74	..	...	...	...	...	...	15
Transferred to Railway Reserve	6,38	3,79	1,49	4,57	2,58	−2,08	−10,93	−4,95	...	...	...	...	...	...

[1] *Central Budget for 1937-8*, p. 41.

[2] Excluding Burma Railways.

Note 1.—The balance of the loss in 1931-2 and the total loss in the following years have been, or will be, met by temporary borrowings from the Depreciation Fund.

Note 2.—Credits for material released from works not charged to revenue were taken in reduction of operating expenses, up to 1931-2. From 1932-3 onwards they have been added to receipts and are included in net miscellaneous receipts. From 1936-7 they are taken in reduction of expenditure met from the Depreciation Fund. The amounts involved are as follows: in 1932-3 and 1933-4, 110 lakhs each; in 1934-5, 90 lakhs; and in 1935-6, 110 lakhs.

Note 3.—Working expenses were reduced in 1930-1 by 166 lakhs by a credit from the Depreciation Fund for correction of past accounting adjustments: and in 1924-5 by 179 lakhs by certain abnormal refunds of expenditure in previous years.

damage caused by floods and earthquakes, the acute rail-road competition,[1] intensified river and sea competition, and increase in working expenses. It has also been pointed out that the tariff policy, not only of India, but of practically all other countries in the world, many of which were in the past our best customers, has adversely affected the earning capacity of the railways.

Owing to these successive deficits the railways failed to make any contribution to general revenues after 1931-2. The accumulated arrears of contribution due under the Separation Convention during the years from 1931-2 to 1936-7 amounted to Rs. 30·74 crores. During the same period the railways not only practically depleted their general reserves but also borrowed from the Depreciation Fund to the extent of Rs. 31·34 crores, in order to meet their obligations regarding interest charges. The utter impossibility of repaying so large a liability of nearly Rs. 62 crores out of future surpluses within a measurable distance of time led to the moving of an official resolution in the Central Assembly during the Budget discussions in February 1937 in favour of cancellation of the entire amount and starting the next financial year with a clean slate. Such a wholesale repudiation of a large debt, however, created a stir in orthodox financial circles both in the Legislature and outside. Meanwhile with the inauguration of Provincial Autonomy under the New Constitution, claims for increased resources were becoming insistent. But as under the existing Separation Convention, loans from the Depreciation Fund were a first charge on future surpluses and there was also thereafter the undischarged liability to general revenues, the latter would have had to wait long before they were entitled to receive any contribution from the railways. 'The escape from this dilemma was found in another resolution that was moved by the Finance Member at the Simla (1937) Session proposing a moratorium of three years for the repayment of the liabilities.[2] Thus while orthodoxy, at any rate in principle, was re-established by the decision not to write off the liabilities of the railways, the moratorium resolution made it possible to permit the appropriation of the surplus of net railway receipts over the interest charges, which has begun to show itself from the year 1936-7, for immediately resuming the contribution to general revenues without making good the heavy liabilities of nearly Rs. 62 crores. This course of action has enabled the Central Government to make a limited

[1] The Wedgwood Inquiry Committee (1937) estimate the loss of railway traffic due to road competition in the neighbourhood of Rs. 4½ crores per annum. *Report of the Indian Railway Inquiry Committee*, par. 169.

[2] See *Capital* (Indian Industries, Trade and Transport Supplement), December 1937, p.26.

assignment of the income tax to the Provinces in the year 1937-8 under the Niemeyer Award (see ch. xi). At the same time it is doubtful whether the railways will be able to redeem the undischarged liability even in the course of a generation.

Anyway it is a matter of genuine satisfaction that the State Railways after six years of disquieting deficits have begun to pay their way and show a surplus of net receipts over the interest charges and appropriations to the Depreciation Fund. This welcome improvement of the financial position of the railways became evident during 1936-7 partly owing to the recovery of trade and prices and partly owing to retrenchment in expenditure. The recovery, however, contains an unstable element, in so far as it has been due partially to the world's rearmament programme. Indeed there has been a definite deterioration in the economic conditions during the past few months.[1] Under the influence of the partial economic recovery the railways have turned the corner and their financial results present a welcome contrast to the earlier dismal record of deficits. The small budget (revised estimates) surplus of Rs. 15 lakhs for 1936-7 turned out to be an underestimate, and the final result was a surplus of Rs. 121 lakhs, which under the Convention then in force was utilized to repay part of the debt to the Depreciation Fund. Similarly, whereas the railway budget for 1937-8 estimated a surplus of Rs. 15 lakhs, the revised figures show that the surplus might be Rs. 283 lakhs after making full contribution to the Depreciation Fund and meeting the interest charges. A surplus of Rs. 2,56 lakhs has been budgeted for the year 1938-9 by the Communications Member.

§16. **The (Wedgwood) Railway Inquiry Committee.**—The very serious deterioration in the financial condition of the railways before the recent partial recovery raised a storm of criticism regarding railway policy and administration throughout the country and created a persistent demand for a searching inquiry into their affairs. Sir Otto Niemeyer, the financial expert who came out to India in January 1936, put in a strong plea for a thorough-going overhaul of railway expenditure and the early establishment of effective co-ordination between the various modes of transport in his Report on Financial Settlement between the Central Government and Provinces under the new Constitution (1935). His Report[2] imparted a new urgency to the problem of financial re-organization of railways by making the assignment of a half share of the income tax by the Central Government to the Provinces dependent upon the Railways paying

[1] This was written in May 1938.

[2] *Indian Financial Enquiry (Niemeyer) Report*, par. 31, published in April 1936. (See ch. xi.)

their way and resuming their contribution to general revenues. The Public Accounts Committee of the Legislative Assembly strongly endorsed Sir Otto Niemeyer's suggestion in its Report issued from Delhi in September 1936, and recommended the early appointment of an expert to survey the whole field of railway finance. Eventually, instead of appointing an expert, it was thought necessary to appoint a Committee of three experts, and accordingly the Indian Railway Enquiry Committee was appointed in October 1936 with Sir Ralph L. Wedgwood, Chief General Manager, London and North-Eastern Railway, as Chairman.

§17. **Recommendations of the Wedgwood Committee.**—The Report of the Committee, published in June 1937, contains many valuable suggestions concerning almost every aspect of railway working for improving efficiency and effecting economy. On certain major topics, there has been considerable opposition to the Wedgwood Report. In the first place, the committee's proposal to abandon the system of contributions to the general revenues in order to place them on a sound financial plane and to provide for possible railway deficits in lean years[1] raised a storm of protest in the Central Legislature and the provinces as going back on the Niemeyer formula which made additional resources for Provincial Governments contingent on the resumption of railway contributions to general revenues. Sir Sultan Ahmed, the Railway Member, disarmed the opposition by emphasizing the Government's anxiety scrupulously to honour the pledges made under the Niemeyer Award, and by reassuring the Central Assembly that assistance would be extended to the provinces out of railway surpluses. In the second place, the reference by the Wedgwood Committee to the necessity for the continued recruitment of Europeans as supervisors in the railway workshops and officers in the commercial departments created deep political resentment, which was however allayed by the assurance of the Government that there would be no departure from the policy of progressive Indianization of the railways. In the third place, the Committee's remarks on the Federal Statutory Authority for Railways (see §22)—on which there has been a sharp cleavage of opinion in India—were deemed to be outside the scope of the terms of reference.[2] The recommendations of the Wedgwood

[1] In this connexion it should be noted that the Wedgwood Committee urge the need for an adequate Depreciation Fund and consider that a normal balance of Rs. 30 crores—the present actual balance in the Fund being only Rs. 14 crores—would not be excessive. In addition the railways should build up a general reserve fund to serve as an equalization fund for the payment of interest charges and amortization of capital. (*Report*. pars. 206 and 210-11.)

[2] *Capital* (Supplement, December 1937), p. 26.

Committee regarding revision of rates and fares, and rail-road co-ordination, are dealt with in later sections.

The Committee rightly urge the importance of the railways increasing their popularity and improving their relations with the public, and to this end recommend closer liaison with the Press through a press liaison officer and a Railway Information Office. The Committee do not favour large amalgamations of railways as a general policy lest they should result in unwieldy administrations.[1]

§18. **Railway rates policy.**—It has been a long-standing Indian grievance that the railway rates in this country have been based solely on considerations of pecuniary advantage to the railways, and, what is much worse, they have been manipulated so as to help European merchants and hinder the development of Indian industries and enterprise. This complaint was voiced by Sir Ibrahim Rahimtulla in the Imperial Legislative Council in 1915, as also by a number of witnesses before the Industrial and Fiscal Commissions and the Acworth Committee. One of the specific charges in this connexion is that the rates are framed so as to encourage traffic to and from the ports at the expense of internal traffic, thus encouraging the export of raw materials and the import of foreign manufactures.[2] Indian business men and industrialists complain that they have often to pay rates which they consider unfair, both on the raw-materials which they have to obtain from other parts of India and on the manufactured articles which they dispatch to various markets. The 'block rates' system[3] has also aroused much discontent as leading to an artificial diversion of traffic inconvenient to industry and trade. An incidental effect of the railway rates policy in the past has been the congestion of industries in the port towns, which is responsible for many of their present difficulties. For example, the serious labour difficulties are to no small extent due to the concentration of the industries in

[1] *Indian Railway Inquiry Report*, chs. xii and xiii.

[2] See *Fiscal Commission Report*, par. 127. It has been urged on behalf of the railways that they favoured external trade because from their point of view it was more important than internal trade and more readily responded to favourable rates; hence greater facilities were given to trade to and from the ports. Recently, however, internal trade has grown rapidly and its claims for special consideration can no longer be denied.

[3] 'Block rates' mean higher mileage charges for short lengths imposed on traffic moving from a station, near a junction with another system, towards the junction in order to travel a much longer distance over that other system, with the object of retaining traffic on the line on which it originates and preventing or 'blocking' it from passing off, after only a short lead, on to a rival route.

centres situated far away from the interior. The adverse effect of the railway rates policy on water transport in India is referred to in a later section.

As the Fiscal Commission admit, the complaints regarding the unfair treatment meted out to Indian industries were not entirely without foundation. In practice the railways have enjoyed full discretion in manipulating the rates within the limits sanctioned by the Railway Board and of putting particular commodities into particular classes.[1] The Industrial Commission, after carefully going into the question, made recommendations in favour of the rating of the internal traffic as nearly as possible on a basis of equality with traffic of the same class and over similar distances to and from the ports, so as to encourage the transformation of the raw materials into the most finished state possible before export. They also recommended that consignments travelling over more than one line should be charged a single sum based on the total distance. The Fiscal Commission endorsed these recommendations, and held that, within the limitations laid down by their predecessors, special rates should be granted for a term of years to new industries, and even to others if they could make out a proper case for special treatment. The Agricultural Commission, who examined the question of railway rates policy in its bearing on agricultural development, suggested a closer co-ordination between the Agricultural Departments and the railways, and recommended the grant of concession rates on the transport of fertilizers, fuel, fodder, milch cattle, etc. They further suggested a re-examination of rates on raw material for, and transport of, agricultural machinery and implements.[2] Some of these recommendations were accepted by the Government of India in April 1930. Agricultural implements have been reclassified with the object of removing anomalies. The rates for carriage of live stock have been examined and reductions have been made. The Wedgwood Committee note the criticism that the structure of Indian railway rates is cumbrous and illogical and calls for drastic simplification. They recommend that the Railway Board should inquire into the system of charging at scheduled rates with a view to simplification.[3]

[1] Professor K. T. Shah holds that 'being originally very costly in construction, and still more costly in operation, (and owing) to their being constructed and maintained without reference to the economic conditions of India, the Railway Rates have been fixed without regard to the nature of the traffic and its effects upon Indian Trade and Industry.'—*Trade, Tariffs and Transport in India*, p. 397.

[2] *Agricultural Commission Report*, pp. 377-9.

[3] *Indian Railway Inquiry Committee Report*, par. 127

As recommended by the Acworth Committee a Rates Advisory Committee consisting of a President, one member representing the commercial interests and another representing the railways, was appointed in 1926 to investigate and make recommendations to the Government on the following subjects: (i) complaints of undue preference, (ii) complaints that rates are unreasonable in themselves, (iii) complaints or disputes in respect of terminals, and complaints that railway companies do not fulfil their obligations to provide reasonable facilities to trade, (iv) the reasonableness or otherwise of any conditions as to the packing of articles specially liable to damage, or liable to cause damage, (v) complaints in respect of conditions as to packing attached to a rate. The Committee's constitutional position is only that of an advisory body, whose findings may or may not be accepted by the Government. The Wedgwood Inquiry Committee recommend that the procedure of the committee should be made more expeditious and more public, and that the Government should ordinarily accept an obligation to refer to the Committee any relevant application (par. 133). Instead of the present Advisory Committee it is desirable that there should be a body with mandatory powers like the Railway Rates Tribunal in Great Britain or the Inter-State Commerce Commission in the U.S.A.

§19. **Reorganization of the Railway Board.**—The Acworth Committee suggested a reorganization of the Railway Board so as to make it a satisfactory agency through which the Government of India could exercise effective supervision over the whole railway system in the country. The reorganized Railway Board consists of a Chief Commissioner, a Financial Commissioner and three members.[1] Instead of the Acworth Committee's recommendation of three territorial divisions with a Commissioner in charge of each, the plan of dividing the work on the basis of subjects has been adopted. One member deals with technical subjects, and another with general administration, personnel and traffic subjects, the Financial Commissioner representing the Finance Department on

[1] The growing importance of labour questions led to the appointment in 1929 of a third member whose main duties are connected with the satisfactory solution of labour problems and improvements of the conditions of service of the staff generally and of the lower-paid employees in particular. Owing to financial stringency certain superior appointments have been held in abeyance since 1931-2. The existing superior staff of the Railway Board consists of the Chief Commissioner, the Financial Commissioner, one member, four Directors, five Deputy Directors, one Secretary and one Assistant Secretary. See *Report on Indian Railways* (1933-4), vol. I, pp. 95-6. For some criticisms and suggestions of the present railway administration see *Indian Railway Inquiry Committee Report* (1937), pars. 78-90.

the Board and dealing with all financial questions. The Board is assisted by five Directors (for Civil Engineering, Mechanical Engineering, Traffic, Finance and Establishments) who relieve the Chief Commissioner and the members of much current work, enabling them to devote their attention to large questions of railway policy, to tour over the various railway systems and to maintain personal touch with Local Governments to a greater extent than was previously possible.

§20. **Railway Advisory Committees.**—The Commitee recommended the establishment of Central and Local Advisory Councils to give the Indian public a voice in railway management. Accordingly all State-owned railways now possess Advisory Committees. There is also a Committee of the Central Legislature consisting of representatives from the Assembly and the Council of State.

§21. **Indianization.**—Both the Acworth Committee and the Lee Commission (1923) recommended the extension of facilities for training Indians for the superior railway services, a standard of seventy-five per cent of such posts being laid down by the latter body. The Government have accepted this recommendation and accordingly the Railway Board has already taken steps to extend training facilities, which are an essential preliminary to the Indianization of the railway services. A railway transportation school has already been opened at Chandausi for the training of subordinate officers, and some area schools have been started for the training of railway staff. It is unfortunate that owing to financial stringency the Railway Staff College which was started at Dehra Dun for the training of railway officers was closed early in 1932. The Government of India recently (August 1937) re-affirmed the policy of Indianization of railway services in the course of the debate on the Wedgwood Committee's Report (see §17 above).

The Acworth Committee also made recommendations for meeting a number of popular grievances. The Government have taken certain steps to this end, such as adding to the rolling stock, extending platform and waiting-room accommodation, erecting new stations, providing better water-supply, appointing Controlling Passenger Superintendents, etc. The third-class passenger contributes the largest amount to the railway earnings from passenger traffic; and, apart from other considerations, it may be good business to increase the attractions of travel for him.

§22. **Federal railway authority.**—By the Government of India Act of 1935 it is provided that, while the Federal Government and Legislature should exercise a general control over railway policy, the actual administration of railways in India (including those

worked by companies) should be placed in the hands of a statutory railway authority which is to be the executive authority of the Federation in respect of the regulation, construction, maintenance and operation of railways. The railway authority is to act on business principles consistently with due regard paid to the interests of agriculture, industry, commerce and the general public. In the discharge of its functions it is to be guided by such instructions on questions of policy as may be given to it by the Federal Government.

Not less than three-sevenths of the members of the authority are to be persons appointed by the Governor-General in his discretion, who is also to appoint one of the members as President.

The authority is to establish, maintain and control a fund (to be called the Railway Fund), and moneys received by the authority, whether on revenue or capital account in discharge of their functions and all moneys provided out of the revenues of the Federation to enable the authority to discharge its functions will be paid into this fund and all its expenditure will be defrayed out of the fund.

The Governor-General may from time to time appoint a Railway Rates Committee to give advice to the authority in connexion with any dispute between persons using a railway and the authority as to rates and traffic facilities which he may require the authority to refer to the Committee.

A Bill or amendment making provision for regulating the rates or fares to be charged on any railways cannot be introduced or moved in either Chamber of the Federal Legislature except on the recommendation of the Governor-General.

The Governor-General is empowered to make rules requiring the authority and any Federated State to give notice in such cases as the rules may prescribe of any proposal for constructing a railway or for altering the alignment or gauge of a railway and to deposit plans.

Any objections on the part of the authority or a Federated State on the ground that the carrying out of the proposal will result in unfair or uneconomic competition with a Federal railway or a State railway must be referred by the Governor-General to a Railway Tribunal which is to consist of a President (appointed from among the judges of the Federal Court by the Governor-General after consultation with the Chief Justice of India) and two other persons selected to act in each case by the Governor-General from a panel of eight persons with railway, administrative or business experience.

An appeal will lie to the Federal Court from any decision of the Railway Tribunal on a question of law.[1]

These provisions of the Government of India Act (1935) regarding the Federal Railway Authority have failed to evoke enthusiasm and indeed have met with considerable opposition on the ground that they considerably detract from the legislative and popular control over railway policy and administration. This also explains the adverse criticism of the recommendations recently (1937) made by the Wedgwood Committee with a view to the avoidance of political and administrative interference with the Federal Railway Authority.[2]

§23. **Economic effects of railways.**[3]—The advantages of railways (as of other means of annihilating distance) from the national, social and cultural point of view are obvious and need not be dwelt upon here. Efficient administration, as well as military defence, internal and external, also requires a properly developed system of railway communications. The economic effects of railways are most important. Famine relief in a country like India necessarily depends on an efficient railway system for quick conveyance of food-stuffs to the affected areas. Further, railways give a powerful impetus to the general economic advance of a country; bring about an equalization of prices throughout the country as well as their conformity with world prices; create new employment and make possible a more even distribution of the population. They are an essential adjunct to the internal and external trade of the country and it is easy to show how passenger and goods traffic have grown with the extension of railways.

The railways have stimulated the agricultural producer in India by widening his markets. The rapid industrialization of the country largely hinges on a satisfactory railway development, facilitating the transport of coal and raw materials as well as the distribution of finished goods. Railways also stimulate engineering industries, and are intimately connected with the progress of telegraphic and postal communications. The effect of railways on the forests has been on the whole beneficial. Railway transport facilities and the demand for railway sleepers have greatly encouraged timber-growing. Th growth of towns and port development are also rendered possible by railways. The invaluable assistance which railways can render in conducting various publicity campaigns for the improvement of sanitation as well as for the introduction of reform in

[1] See *Government of India Act* (1935), §§181-99.

[2] *Report of the Indian Railway Inquiry Committee*, pars. 215-21.

[3] See §1 of this chapter.

agricultural practice has already been referred to.[1] Lastly, Government revenues benefit both directly and indirectly from the railways: directly, because the Government share in the profits from the railways, and indirectly, because they increase the total wealth of the country and consequently the taxable capacity of the people.

Railways, however, have not been an unmixed boon in India. We have already spoken of the part which railway construction has played in hastening the destruction of indigenous industries and in bringing about the one-sided economic development of the country, under which its exports consist almost entirely of raw materials, and its imports of manufactured articles. As regards the help derived from railways in the matter of organizing effective famine relief, we must not ignore the fact that there is another side to the picture. Railways have increased the ruralization of the country by contributing to the decline of the indigenous industries, and this has rendered large numbers of people, especially artisans like weavers, more susceptible to famine than they used to be. Thus if the railways have facilitated the work of famine relief, they may be said, on the other hand, to have increased the volume of this work. In the earlier days of railway development, the fuel requirements of railways led to the reckless destruction of forests until the Government took the necessary steps to check this process. Railway development in this country has also meant the introduction of foreign capital and foreign investment, and this, as we have already seen, has brought certain disadvantages along with some advantages.

§24. **Need for further railway development.**—Most of these adverse effects, however, are properly attributed not to railway construction as such but to the manner in which it was brought about and the undue haste that was displayed in connexion with it. We must not, therefore, be led by some of the unfortunate consequences that have actually followed from railway construction in India to suppose that it would be in the interests of the country to impede further railway development. On the contrary, it is of the greatest importance that, subject to proper safeguards, railway development should be pushed as fast as possible, in order to expedite the industrial and commercial progress of the country. That India is poorly provided with railways can be seen from the fact that, while Europe (excluding Russia) covers 1,660,000 sq. miles and has 190,000 miles of railways, India contains 1,803,000 sq. miles of country and has but 39,712 miles of railways (1928).[2]

[1] See vol. I, ch. viii, §2.

[2] Speech of the President, Indian Railway Conference, 1928.

Particularly when judged by the standard of population, India is much worse provided with railway facilities than are many other countries. It would of course be absurd to contrast the railway mileage of agricultural India, with her vast mountain ranges, great river estuaries, wide-spreading deserts and barren places, with that of a highly industrialized, compact country like England, whose every square mile, almost, is made to contribute something to the national income. Further, it must be remembered that the need for communications in India can most effectively and cheaply be met in many cases by mechanized road transport and water carriage in preference to railways. But even after allowing for all this, there is undoubtedly a great deal of work which still remains to be done by way of extension of railways. It is also important that every possible effort should be made to raise the required capital in India, if only to keep within bounds the further growth of foreign capital in the country. Lastly, it is essential that railway industries should be developed and fostered along with railway construction. This is a matter which has so far been almost entirely neglected. The danger of India's dependence on outside supplies for railway materials and even for ordinary repairs was fully disclosed in the late War. It is urged, therefore, that steps should be taken to put an end to this dependence. Otherwise also, in the general interests of industrialization, the case for indigenous railway industries is clear.

Road Transport

§25. **Recent road history.**—The unsatisfactory state of road transport in India about the middle of the last century has already been alluded to. The East India Company, being mainly a commercial corporation, neglected an important duty of a civilized Government in that it took little interest in road-making. The limited progress that was made was due to the initiative taken by individual administrators like Lord William Bentinck, who revived the idea of a highway connecting the north of India with Bengal, resulting in the construction of the Grand Trunk Road linking Peshawar with Delhi and Calcutta. The little importance attached by the Company to the road needs of the civil population is shown by the fact that roads were then placed in charge of Provincial Military Boards instead of being entrusted to a special Public Works Department.

India, however, entered upon a new epoch of road-making during the time of Lord Dalhousie, who, in addition to his active interest in the promotion of railways, also initiated a more vigorous road policy, and for this purpose, over and above the central Public

Works Department, there were created in 1855 similar departments in each province replacing the old Military Boards. A second factor which has promoted road development during the last seventy-five years has been the influence of railways. As railway construction proceeded apace it became increasingly necessary to build roads to feed the railways rather than to compete with them, 'leading to a demand, which remains today far from being completely satisfied, for bridged and metalled roads at right angles to the railways and giving access to them in all the seasons of the year'.[1] It is necessary, however, to point out that the extension of railways and the intimate financial interest of the Government in their profitable working has led to a certain neglect of roads, especially of trunk roads where they run parallel to the railways.[2] The progressive policy of Lord Mayo and Lord Ripon with regard to local self-government, under which local control over local affairs was provided, acted to some extent as a stimulus to road development. The total effect of all these factors is reflected in a considerable activity in road-building during the last eighty years or so. 'The Grand Trunk Road has been extended from the Ganges valley to Peshawar, good metalled arterial and district roads have been driven over the plains and through the hills of every part of India, and thousands of miles of serviceable *kacha* or non-metalled roads and useful bridle-tracks have been made. There can be no question that every district in India has immensely increased the amount of wheeled transport within its limits, even during the past two or three decades, and the extent of this expansion is a measure of the growth of India's road-system and of its economic value to her people.'[3]

§26. **The main features of India's road system.**—There exist at present four great trunk roads stretching across the country, with which most of the important subsidiary roads are linked. The most famous of the trunk roads is the ancient marching route for armies, known as the Grand Trunk Road, which stretches right across the northern part of the country from Khyber to Calcutta; the other three connect Calcutta with Madras, Madras with Bombay and Bombay with Delhi. These four main roads accounted for about 5,000 out of the 82,284 miles of metalled roads in British India in 1935-6. Southern India is most favoured both as regards the number and the satisfactory character of its subsidiary roads. The worst-served regions are Rajputana, Sind, parts of the Punjab, Orissa and Bengal. Aridity, sparseness of population, unbridged

[1] *Agricultural Commission Report*, p. 370.
[2] See *Road Development Committee Report*, par. 17.
[3] *India in 1926-7*, p. 261.

and unbridgeable waterways, difficulties of the ground and lack of suitable road materials are some of the obstacles that have prevented more rapid progress. Besides metalled roads there is a very large mileage of *kacha* (unmetalled) roads in British India, being 224,433 miles in 1935-6, some of which provide quite good going for motor traffic during the dry weather.

On the whole, however, the total mileage of 306,717 of metalled (82,284) and unmetalled (224,433) roads in 1935-6[1] must be regarded as meagre considering the continental dimensions of the country. It would be reasonable to say that India's road system even before the advent of motor transport was altogether insufficient for her needs.

This deficiency[2] of roads is keenly felt in rural areas in respect of smaller feeder roads connecting with trunk roads or the railway line, and many a village continues to be inaccessible and is denied facilities of communication.

Apart from the inadequate equipment of the country in the matter of roads and, at any rate until recently, the lack of system and continuity in the road programme, another unsatisfactory feature is the fact that existing roads have been allowed to deteriorate in recent years. This deterioration has been most marked in the case of roads maintained by local bodies. Their poor resources have been mainly responsible for this state of affairs. We must, however, reckon with a new factor in the situation, namely the astonishing rapidity with which motor traffic both of private cars and especially of the public motor omnibus has sprung up all over India in recent years, thus creating an entirely new range of problems of road construction and maintenance. It is true that the motor lorry has scarcely affected the use of the bullock-cart for the conveyance of agricultural produce and manufactured articles, even over long distances, owing, *inter alia*, to the difficulties presented by the hopeless condition of many roads and the presence of many unbridged rivers even on the arterial roads, and the competition of railways. But as these difficulties are overcome, we may expect a considerable part of the goods traffic to be captured by mechanized transport, especially in view of the improvements that are taking place in the technique of the trucks. This development is especially

[1] Out of the total road mileage (306,717 in 1935-6) in British India, 48,129 miles of roads were maintained by the Public Works Department, 20,642 by municipalities and 237,946 by District and Local Boards. See *Statistical Abstract for British India* (1935-6). Table No. 232.

[2] The Agricultural Commission point out that while there are 80 miles of roads per 100 sq. miles of area in the U.S.A., there are only 20 miles of roads per 100 sq. miles of area in India (*Report*, par. 299).

likely in hill tracts, where railway construction would not be economical, but a motorable road is possible. In the vicinity of large towns, again, motor transport has another opportunity in respect of carriage of perishable goods.

§27. **Need for more roads.**—We need hardly stress the importance of good road communications in a continental country with predominant agricultural interests and with its industries struggling to develop. As the Agricultural Commission remark, 'Transportation is an integral part of marketing, and modern commercial development tends everywhere to enhance the value and importance of good road communication.' India has a large volume of internal and external trade capable of considerable expansion in the future. Also, the provision of good communications is the surest way of stimulating agricultural production and raising the standard of life in rural areas. Incidentally it will lessen the constant strain on the health and stamina of draught animals and increase their efficiency. Again, roads will be of particular assistance for the development of industries connected with the preparation of agricultural produce for export or internal consumption. They will also facilitate the decentralization of industries—the undue concentration of which at present is a source of many of their difficulties, especially in connexion with labour-supply and housing. They will bring within the bounds of possibility the establishment of 'garden factories', and thus evolve the form of industrialism most suited to the needs of the Indian worker who thrives best in a rural environment. The example of foreign countries should serve both as an encouragement and a warning. The United States and Denmark owe not a little of their prosperity to their excellent system of communications and mechanized transport. On the other hand, the blighting influence of poor communications is illustrated by Russia, which, in spite of great agricultural resources, has been at times scarcely able to feed the population in her towns and industrial areas, while the wheat has been rotting in her rich southern fields. Lastly, the large forest wealth of India can only be exploited effectively with the help of suitable road transport.

§28. **Roads versus railways.**—Though a considerable expansion of railways has been planned for the near future, it is hardly likely that for many years to come this vast country will be provided adequately with railways as judged by its needs and the standards attained in many foreign countries. In order to open up the hinterland and link it with the large industrial centres and ports, reliance will have to be placed to a very great extent on roads. A network of arterial and feeder roads is what the country requires. No doubt the construction of roads involves

heavy initial expenditure and further expenditure for maintenance and repairs from year to year. The railways are, however, an even more costly form of inland transport, at any rate, for local traffic. For relatively lighter traffic and for short distances the road is probably more suitable, especially as it can be constructed almost anywhere at a considerably lower cost than a railway.[1] At the same time it must be remembered that conditions of weather in India, often alternating between extreme dryness for many months of the year and continuous and heavy rainfall concentrated in a short period, render the maintenance of roads capable of carrying heavy motor traffic extremely expensive, and the advantage here would probably be on the side of railways. Generally speaking, however, road transport will be cheaper than railway transport, as it does not require stations, sheds, signals, sidings, etc.; nor does it involve any loss of time at the termini with their special charges; nor encounter problems of carrying half-empty wagons, and of allowing a good deal of rolling stock to remain idle, and so forth. It has, however, been pointed out that the cheapness of road transport is in some measure due to the fact that the heavy cost of maintaining roads suitable for mechanized transport has to be borne at present mostly by the general taxpayer, while the railways themselves have to pay for the whole cost and upkeep of their permanent way. But even if motor traffic is made to bear a substantial part of the charge of maintaining the roadways, road transport will generally retain the advantage of greater cheapness. This applies, as already stated, to lighter traffic and short journeys. On the other hand, the railways will hold their own and will be a more convenient and economical form of transport for heavy loads and longer distances, owing, among other things, to their much smaller running charges. Over a certain part of the field, roads and railways are alternative and competitive. Over another not insignificant part, however, they are complementary and mutually helpful. This point has been well put thus. 'The road system links up the cultivator's holding with the local markets and the nearest railway station, while the railway provides the connecting links between the area of production and consumers at a distance, and between the manufacturer in the town and the cultivator who purchases his ploughs, his fertilizers, or his cloth. Without good roads and sufficient roads, no railway can collect for transport enough produce to render its operations possible, while the best of roads cannot place the producer of crops in touch with the

[1] In days to come the aeroplane will have no rival for the quick transport over thousands of miles of light and valuable goods.

consumer.'[1] There is therefore no reason to suppose that the national investment of some Rs. 800 crores in railways is likely to be jeopardized by the extension of road communications. In fact, as the Railway Board's *Memorandum to the Road Development Committee* points out, railways in India have always been acutely conscious of the lack of roads to feed them.[2] No doubt, a certain amount of competition between railways and roads cannot be avoided, and the railways in India are feeling the pressure of this competition, not only in the neighbourhood of large cities and suburbs, but also in other parts of the country where motor services run parallel to or short-circuit railway routes, as between Poona and Ahmednagar. The general policy adopted by the railway administration is to afford to the public an equal or better service than road transport can give, while taking full advantage of the additional business brought to railways by such motor transport as can act as feeder or distributor. Motor services have often been started because the railways have failed to meet the public demand in some way or other. Their competition has thus been sometimes advantageous from the public point of view in so far as it has forced the railways to attend better to the needs of the public.

§29. **Counter-measures to meet road competition.**—Among the methods of meeting road competition are railway omnibus services such, for example, as those run by the East Indian Railway, self-propelled coaches like the sentinel services and shuttle trains, time-table adjustments, cheap return tickets, quotation of special terms for marriage parties, special trains at concession rates, greater publicity for railway services, facilities and charges.[3] The Wedgwood Committee recommend a series of counter-measures for dealing with road competition. As regards passenger traffic, they favour faster passenger trains, better connexions, more intensive services, and improved amenities for lower-class passengers. They deprecate any wholesale reduction of fares to meet road competition. Fares should only be reduced locally to meet specific cases of diversion or threats of diversion. Indian railways should do more to develop traffic through booking agencies. As regards goods traffic, the Committee recommend faster goods trains, more expeditious handling of goods, simplification of clerical formalities, development of collection and delivery services, use of containers and of railway-owned refrigerator trucks, etc. As modern

[1] *Agricultural Commission Report*, par. 312.

[2] 'It is indeed somewhat incongruous that there should be nearly 40,000 miles of railway in India, while the total mileage of surfaced roads in British India is only 59,000.'—*Road Development Committee Report* (1928), par. 36.

[3] *Report of the Railway Board on Indian Railways* (1936-7), par. 51.

conditions demand quicker transit, it is desirable for railways to sacrifice full wagon loads or train loads in the interest of better service. A general reduction of rates to meet road competition would involve the railways in a heavy loss of revenue. The railways should, therefore, continue their policy of judicious reductions in individual rates.[1]

§30. **Transport co-ordination policy.**—While it may thus be difficult to arrange for a policy of co-ordination between the two forms of transport, it is possible to adjust new programmes of road and railway extension in such a way that roads may serve rather as feeders of the railways than competitors for such traffic as the railway is capable of handling more efficiently and economically, and to avoid in India the senseless and wasteful competition between rail and motor traffic that is today taking place in many European countries. Funds available for capital expenditure on transport should be largely devoted to the construction of roads in such a way as not to duplicate existing transport facilities, precedence being given to the construction and development of non-competitive roads in areas with little or no transport facilities. Careful co-ordination is necessary to ensure the allocation to each different form of transport service of work for which it is best suited. The Mitchell-Kirkness Report recommends for this purpose the creation of a Central Advisory Board of Communications in the provinces and Divisional Committees in the Commissioners' Divisions. This Report was the result of an inquiry which was conducted during 1932-3 by a small committee of two officers, Mr K. G. Mitchell, Road Engineer with the Government of India and Mr L. H. Kirkness, Officer on Special Duty with the Railway Board, into existing road and railway competition. Their Report suggests a better control of motor transport as one of the methods of making this competition fair. It further recommends: (i) the zoning of motor transport on parallel competitive routes within a range of about fifty miles; (ii) the operation of motor transport by certain railways on roads parallel with railways; (iii) revision of the system of taxing motor transport; and (iv) review of pending railway projects in the light of recent developments in motor transport.[2] The Road-Rail Conference which was convened, in pursuance of the recommendations of the Mitchell-Kirkness Committee, at Simla in April 1933, adopted resolutions relating to questions concerning the co-ordination of effort between the various authorities responsible for the development and control of the different forms of transport so as to

[1] *Indian Railway Enquiry Report*, pars. 169-89. See also §31 below.

[2] See *Mitchell-Kirkness Report*, p. 24.

reduce uneconomic competition between them. Among other methods the Conference favoured the removal of the statutory embargo on certain railways operating road motor services, the grant of monopolies of road transport services with a view to developing rural services, and the creation of machinery at the centre and in the provinces designed to secure the co-ordination proposed. The Railway Act was accordingly amended in September 1933, empowering railways to run motor services in conjunction with rail transport. A Transport Advisory Council consisting of the Ministers in charge of roads in the various provinces or their representatives, with one or two Council advisers, has also been recently (1935) formed. Its function is to arrive at a considered statement of road policy which might be generally acted upon by the provinces for the furtherance of the co-ordinated development of road, rail, and other forms of transport—a purpose of the very highest importance for the economic development of the country.[1]

§31. **Wedgwood Committee on rail-road co-ordination.**—The Wedgwood Committee recently (1937) examined the question of the co-ordination of rail and road transport. The Committee find that regulation of road transport by Provincial Governments is inadequate and that conditions are chaotic. The policy hitherto followed by the Provincial Governments encourages an unorganized and inefficient type of road transport whose competition will cripple the railways without providing a trustworthy service on the roads; whilst on the other hand, the control exercised by the Central Government on the expenditure on roads from the Road Fund (see §§34-6 below) can only be made effective by delaying or restricting the provision of an adequate road system, which is a public need of the first order quite irrespective of the railways. In this way, a continuance of the present policy seems certain to give India the worst of both worlds—unprosperous railways and inadequate roads.[2] Effective co-ordination can only be brought about by operating both road and rail transport as public services. The committee do not agree with the view expressed by critics of the railways that regulation of road transport is advocated merely for the sake of protecting the railways. Proper regulation of road transport is necessary not only in the interest of safety but also to guide its own development along sound and economic lines. It is also desirable that the railways should be protected against unfair

[1] For an instructive discussion of the question of co-ordination see S. K. Guha, *Problems of Transport Co-ordination in India*.

[2] *Report*, par. 138.

and uneconomic inroads by a new competitor. The regulation of roads should be carried out by Provincial Governments in accordance with uniform principles enacted by the Central Government. No restrictions, however, should be imposed on road transport which would unfairly hamper its development. Measures of regulation should be common to buses and lorries in the interest of public safety, and should cover the following conditions: fitness of vehicle, prevention of overcrowding and overloading, speed limits, limitation of hours of duty and fitness of driver. Licenses should be issued in accordance with public need so as to avoid excessive provision and maldistribution of road transport facilities. Passenger services should be regulated by a system of route-licensing, and time-tables and fares should be fixed. The Committee recommend a system of regional licensing for goods vehicles, and suggest statutory provision in order that goods rates may be regulated at some future date. The same system of regulation should be applied to private lorries as to public lorries. Legislative effect should be given to these recommendations by means of a mandatory act; failing that, the Motor Vehicles Amendment Bill should be passed as quickly as possible. Police control for enforcing provincial rules should be strengthened and the provinces should aim at uniformity in the taxation of motor vehicles.

The Wedgwood Committee strongly recommend participation in road transport by railways and to this end propose that railways should have full powers to run road services, to invest money in or enter into working agreements with road transport undertakings and to arrange road transport services through contractors. The railways should immediately examine the possibility of passenger and road services and place their proposals both as regards competitive and feeder services before the Provincial Governments. Finally the Committee urge the importance of voluntary co-ordination between railways and the more responsible elements in the road transport industry.[1]

§32. **Regulation of road motor traffic.**—In the light of the recent report of the Motor Vehicles Insurance Committee, the Wedgwood Committee, and consultations held with the various Provincial Governments, as well as the third Transport Advisory Council, a comprehensive Bill has been framed and referred to a Select Committee of the Central Assembly (March 1938).

The Bill (Motor Vehicles Bill) has two main aspects, (i) regulating and (ii) co-ordinating. Its general scheme is that control of transport vehicles carrying passengers or goods for hire or

[1] *Indian Railway Inquiry Committee Report*, pars. 135-67.

otherwise should be in the hands of transport authorities constituted for specified areas within the province, and that for the purpose of co-ordination, hearing appeals, etc., there should also be constituted a transport authority for the province. All motor vehicles must be covered by a permit issued by the transport authority of an area, and the holder should be required to observe certain well recognized conditions, such as satisfactory maintenance of the vehicle, the observance of prescribed speed limits, and the avoidance of overcrowding the vehicle or overworking the drivers. The constitution of the provincial authority is permissive. It may be required for purposes of co-ordination, or to settle differences between regional authorities, or to increase control over through routes.

In granting permits for motor buses and taxis the transport authorities are required to bear in mind certain general guiding principles, viz. public necessity and convenience, the prevention of uneconomic competition, and the suitability of the roads to carry the forms of transport seeking permits. In the case of public goods traffic, the principle adopted is that, while the transport of perishable goods by road over short distances, in order to avoid the delay and damage caused by terminal transhipment, should not be interfered with, long-distance traffic should be left primarily to railways. It is provided that a route-permit holder, in return for the security given to him against unreasonable competition, should maintain a regular service, i.e. have the responsibility of a public utility company. Power is to be given to the regulating authorities to fix minimum and maximum rates for traffic on the roads.

A notable feature of the Bill—and the one which has caused the most acute controversy—is the provision relating to compulsory insurance of motor vehicles (after 5 years) in respect of third party risks. This provision may be welcomed in view of the numerous motor accidents on roads in this country and is essential for enforcing the social responsibility of public carriers.

It is provided that motor licenses should be valid throughout British India, without detriment to the right of a province to fix its own motor taxation. Applicants for new licenses would be required to pass a special prescribed test.

Although some of the features of the new Bill have given rise to controversy it is non-contentious in principle and has been rightly described as a ' highway code '. There is a welcome and growing recognition of the necessity of evolving order out of chaos and of devising measures for a co-ordinated system of transport.

§33. **Indian Road Development Committee.**—The rapid extension of motor traffic in India in recent years[1] has led to a growing realization on the part of the Imperial and the Provincial Governments of the necessity of a comprehensive road programme to co-ordinate local programmes and evolve a common policy. Road Boards have already been established in Bombay, Burma, Madras, the Punjab, and the United Provinces. These Boards are mainly advisory, except in the Punjab and Burma, where they are also entrusted with the distribution of grants-in-aid from provincial funds. In November 1927, the Government of India appointed the Road Development Committee, consisting of fourteen members of the Central Legislature and presided over by Mr M. R. Jayakar. The Committee were asked to make recommendations on (i) the desirability of developing the road system of India; (ii) the means by which such development could most suitably be financed; and (iii) the co-ordination of road development and research and road construction by the formation of a Central Road Board, with due regard to the distribution of central and provincial functions.

§34. **Road finance.**—As the Indian Road Development Committee observe, 'road development in India is passing beyond the financial capacity of Local Governments and local bodies, and is becoming a national interest, which may, to some extent, be a proper charge on central revenues '. The central revenues benefit from the development of roads, not only through enhanced railway receipts, but also through customs and excise receipts from motors and motor spirit, which are rapidly expanding.[2] A well-balanced scheme of motor taxation should include duty on motor spirit; vehicle taxation; and license fees for vehicles plying for hire: and the proceeds should be spent on road development. It has been suggested that a reclassification of roads should be made so as to transfer some of the local roads to the category of arterial roads, and thus reduce the burden on local bodies and enable them to devote more attention to feeder roads and roads of purely local importance. As the Road Committee point out, the iniquity of causing the smaller units of government to bear all the cost of main road

[1] In 1936-7 the number of motor cars imported into India was 12,939 (including 9,160 motor omnibuses and vans). The peak of motor car imports was reached in 1928-9 with a total of 19,657 (including 12,790 omnibuses, etc.). The total number of all classes of motor vehicles running in British India up to the end of March 1937 was 171,463 (including 40,941 lorries, buses, etc.). *Review of the Trade of India* (1936-7), pp. 60-2.

[2] It is estimated that motor transport contributes about Rs. 830 lakhs annually in the shape of taxation of which Rs. 100 lakhs is credited to the Road Development Account through petrol taxation, Rs. 430 lakhs goes to the central revenues, and Rs. 300 lakhs goes to the provincial, State and local revenues.

improvements seems to be recognized all over the world. The local bodies also require more liberal financial assistance from provincial funds. The adoption of the above recommendations made by the Road Committee would indirectly benefit village roads by the release of provincial revenues and local funds, which are now being spent on main roads to meet the requirements of motor transport. The Road Committee also favour contributions by the railway administration towards the construction and maintenance of feeder roads. The Committee deprecate the levy of road tolls on any traffic (except tolls on bridges where a definite service is provided to replace a ferry or a bad river-crossing) as being obstructive to a rapid form of road transport and as causing harassment to traffic of all kinds. They should be replaced, where necessary, by a less vexatious form of taxation. The Agricultural Commission recommend the revival of the old system of corporate labour of the village community which may receive financial assistance from the Government, provided it is prepared to do its part of the job.

It remains to consider how far road development may properly be financed from loans. The Agricultural Commission express the view that the policy of road development would be much better carried out if, instead of relying solely on current revenues, loans were raised for financing road programmes. They hold that in view of the quasi-permanent character of the roads and the works connected with them, the annual amount required for the amortization of provincial loans raised for this purpose should not be a heavy charge on the resources of a province for the upkeep of local village roads.[1] The Road Committee hold that the propriety of raising such loans must be decided by each Local Government for itself according to its circumstances. They deprecate large schemes of road expansion financed by loans, for the service of which provincial revenue might be mortgaged for long periods while other departments of the Government which may not be less important may be starved. They recommend that only construction or reconstruction should be financed from loans; that loans should be for short periods; that there should be revenue clearly in sight to cover not only the interest and sinking fund charges, but also the cost of maintaining the road when constructed, and that construction from loans should preferably be confined to the more permanent parts of a project such as a bridge, the life of which can be estimated with fair accuracy for the calculation of the sinking fund, while the cost of maintenance is small. The Road-Rail Conference of 1933 recommended that a comprehensive plan should

[1] *Agricultural Commission Report*, par. 306

be drawn up with a view to examining the possibility of development of both main and subsidiary roads from loan funds within the limit of the resources available for maintenance (see also §37 below).

§35. **The new road policy.**—In accordance with the principal recommendation of the Road Committee, the Indian Finance Act of March 1929 introduced an increase in the import and excise duties on motor spirit from 4 to 6 annas per gallon (from which an additional revenue of Rs. 94 lakhs was received in the year 1929-30). Sir B. N. Mitra tabled a resolution in the Assembly on 11 September 1929, in accordance with the recommendations contained in paragraphs 70 to 79 of the Road Committee's discussions. The principal features of the convention embodied in the above resolution are as follows:—(i) To ensure some continuity in road programmes, the increased duties on motor spirit shall be maintained for a period of five years in the first instance. (ii) The proceeds of the additional duty during the same period shall be allotted as a block grant for expenditure on road development to be credited to a separate road development account, the unexpended balances of which shall not lapse at the end of the financial year. (iii) The annual grant shall be divided as follows:—(*a*) The Government of India shall retain ten per cent as reserve for two years ending 31 March 1931, and the position shall be reviewed thereafter. From this reserve special grants may be made, where for some reason there is need for special aid, for example for projects beyond the resources of local Governments or those that concern more than one province or State, or a bridge over a river on a provincial or State boundary. (*b*) Out of the remainder (1) an apportionment shall be made among the provinces in the ratio which the consumption of petrol in each province bears to the total consumption in India in the preceding calendar year; (2) the balance representing the consumption of petrol in minor provinces, administrations and Indian States shall be allotted as a lump sum to the Government of India. (iv) Grants shall be made to each province for expenditure on such schemes as are approved (except in the case of Burma) by the Governor-General-in-Council with the advice of the Standing Committee for Roads. (v) A Standing Committee for Roads shall be constituted every year, consisting of certain elected and nominated members of both the Houses of the Indian Legislature, under the chairmanship of the member of the Governor-General's Executive Council in charge of the department that deals with roads. This Committee shall advise the Governor-General-in-Council on all matters relating to roads including central research on roads, and any action to be taken by the Government of India on the proceedings of the periodical road conferences. (vi) All proposals for

expenditure from the annual grant or its accumulated balance shall be submitted for approval to the Finance Sub-Committee, consisting of the Chairman of the Standing Committee for Roads and of its members who are also members of the Legislative Assembly.

This convention was adopted by the Assembly at the Delhi Session (February-March 1930) for a period of five years.

The Road Committee do not recommend reliance on a Central Road Board with executive powers administering a separate road fund. They are also opposed to the creation of a separate elaborate Central Road Department as unnecessary and also as leading to undue interference with Local Governments. The necessary co-ordination can best be effected through a periodical road conference of representatives of the Government of India and Local Governments, who would meet from time to time to exchange views on matters of common concern. The Committee further recommend the appointment of a Road Engineer to the Government of India who should also act as secretary to the road conference. The Government of India are asked to reconsider the recommendation of the Acworth Railway Committee and the Inchcape Retrenchment Committee in favour of the constitution of a Central Communications Department to ensure a single policy in respect of the development of roads and railways.[1] This recommendation was recently (November 1937) given effect to in connexion with the reshuffle of Government of India Departments. The new Department of Communications in charge of the new Member for Communications has taken over railways, posts and telegraphs, civil aviation, broadcasting, meteorology, roads, ports and inland navigation.

§36. **Financial position of the road account.**—The total revenue during the first five years of the Road Development Account amounted to Rs. 518 lakhs. The revenue actually credited to the account (up to 30 September 1933) before the close of the year was some Rs. 460 lakhs. After deducting 10 per cent for the reserve, the balance available for distribution was Rs. 414 lakhs. Of this Rs. 344 lakhs was distributed to the ten Governors' provinces, the individual shares varying from Rs. 75 lakhs for Bombay and Rs. 60 lakhs for Madras and Bengal, to about Rs. 9 lakhs for Assam and Rs. 8 lakhs for the North-West Frontier Province. The expenditure in the nine provinces excluding Burma was about Rs. 192 lakhs. In addition to this, on account of the prevailing financial position, five Provincial Governments were permitted to borrow about Rs. 55 lakhs from their share in the account. The

[1] See *Road Development Committee Report*, pars. 87-90.

unspent balance (about Rs. 97 lakhs) was carried forward. **Out of** the reserve, Rs. 5 lakhs was set aside for grants for road experiments and research. The appropriations to the Road Fund were Rs. 159 lakhs in 1934-5, Rs. 129 lakhs in 1935-6, Rs. 140 lakhs (revised) in 1936-7 and Rs. 141 lakhs (Budget) in 1937-8.

§37. **New road resolutions.**—(i) The probationary five years for which the road account was first instituted came to an end in 1933-4. As recommended by the Road-Rail Conference after consultations with Provincial Governments, a new resolution governing the road account was adopted by the Central Legislature in April 1934, which placed the account on a more or less permanent basis. It increased the reserve at the disposal of the Government of India from ten to fifteen per cent so as to enable them to deal more liberally with the less developed provinces. It provided for the service of loans for road development and in special cases for the maintenance of roads constructed from this account or from loans as admissible charges on the account.[1]

(ii) On the recommendation of the Transport Advisory Council a new Road Resolution regarding the allocation of grants from the Road Fund to the Provinces was recently (February 1937) passed by the Central Assembly. The main changes are as follows: (*a*) The shares allocated for expenditure in the Governors' Provinces would in future be retained by the Governor-General-in-Council until they were actually required for expenditure in order to ensure prompt utilization of the money placed at the disposal of the provinces. (*b*) The Central Government has been empowered to resume the whole or any part of the sums which the Central Government might hold for expenditure in any province if the province delayed without reasonable cause to utilize its share in the Road Fund for the purpose of road development. (*c*) But the most important change is effected by the clause which authorizes the Governor-General-in-Council to resume the share of the province if it fails to take such steps as he might recommend for the regulation and control of motor vehicles within the province. This last provision has given rise to acute controversy and is resented by the provinces as amounting to unwarranted interference in their road policy by the Central Government, in order to protect the budgetary position of the railways. Sir Frank Noyce, speaking on behalf of the Central Government, argued that it was not inequitable to attach conditions to the grants made from the Road Fund, to prevent the funds being used by the provinces as they liked. The object of the resolution was to secure a balanced system of

[1] *India in 1933-4*, p. 111.

communications.[1] (*d*) The provision in the earlier resolution allowing the use of the Road Fund for defraying the charges on road loan has been discontinued (without prejudice to the existing commitments) with a view to the impending inauguration of Provincial Autonomy.

Although this latest resolution on the Road Fund indicates the possibility of a clash between the Central Government and the provinces, no great friction need necessarily occur since under the ingenious financial scheme of Sir Otto Niemeyer, the provinces are interested in the solvency of the railways and in taking measures for not allowing motor transport seriously to damage railway earnings. (See ch. xi.)

Water Transport

§38. (i) **Inland waterways.**—With reference to India the discussion of the subject of water transport may conveniently fall under two broad divisions: (i) inland waterways, and (ii) marine transport.

India is not favoured by nature to the same extent as England with rivers which serve the purpose of natural waterways. We have already noted the contrast in this respect between the rivers in northern India and those of the peninsula.[2] It is stated that there are about 26,000 miles of navigable waterways in connexion with the great river systems of northern India. The Indus, the Ganges, the Brahmaputra, and the Irrawaddy are navigable by steamers all the year round, or for the greater part of the year, for hundreds of miles above their mouths or above the heads of navigable canals traversing their deltas. Thus the Indus is constantly navigable as high as Dera Ismail Khan in the North-West Frontier Province, 800 miles inland. Its tributaries, the Chenab and the Sutlej, are open to small craft all the year round. The Fuleli Canal and the East Nara may be regarded as navigable branches of the Indus. The Ganges is navigable as high as Cawnpore, and steamers pass up the Gogra as far as Fyzabad, though the development of rail traffic has led to a considerable decline in the steam navigation on the Indus and the Upper Ganges. The Brahmaputra is navigable by steamers as high as Dibrugarh, and there is steam navigation on its tributary, the Surma, as far inland as Sylhet and Cachar. The Hooghly is navigable all the year round up to Nadia and further up from July to October.

[1] As Sir James Grigg pointed out, it was impossible for the Government, with a capital of Rs. 800 crores invested in the railway system, to subsidize unconditionally a competing form of transportation.

[2] Vol. I, ch. ii, §10.

The rivers in the peninsula do not, however, lend themselves to navigation. According to seasons they either flow in torrents or are reduced to mere strings of pools amidst a wilderness of sand or deep gorges, making navigation impracticable. The rocky beds and swift floods of some of the rivers, like the Narbada and Tapti, are insuperable obstacles to navigation. The Mahanadi, the Godavari and the Kistna are indeed navigable in their upper reaches, but the traffic on them is not very considerable.

In addition to these somewhat restricted facilities for river traffic in the country, there are all round the coast innumerable small rivers, creeks and backwaters affording facilities for water transport which are fully utilized by small native craft; but outside the zone of such operations inland navigation is practically confined to the deltas and valleys of the great rivers which form the natural waterways of the country.

Inland navigation was largely resorted to in the old days and there was a considerable volume of river traffic in the time of the Mauryan and the Mogul empires. For example, the Ganges was the great natural highway of commerce, and on its banks flourished several towns like Mirzapur, which was a great centre of trade between central India and Bengal. Since the advent of railways, however, inland navigation has received a set-back. As the Industrial Commission point out: 'In the absence of a representative specially charged with their interests (that is, those of the existing waterways) the vested interests of the railways have prevented waterways in India from receiving the attention that has been given to them in other countries with such satisfactory results.'[1] The Acworth Committee also repeat the view that waterways have suffered by unfair competition on the part of the railways, and they cite the case of the river port of Broach in Bombay and the Buckingham Canal in Madras in support of their contention.

At one time there was a good deal of agitation in favour of navigable canals.[2] Sir Arthur Cotton, 'the architect of the magnificent Kaveri and Godavari works', prepared an ambitious scheme of navigable canals, which was put before a Parliamentary Committee in 1872. He contended that water-carriage facilities were more suitable for India and less expensive than railways—which then seemed to have failed miserably—and had the further advantage that they could sometimes be combined with irrigation. 'The principal lines of navigation which Sir Arthur Cotton recommended were (i) from Calcutta to Karachi up the Ganges and down the

[1] *Industrial Commission Report*, par. 279.

[2] See Dutt, op. cit., pp. 360-77.

Indus; (ii) from Coconada to Surat up the Godavari and down the Tapti; (iii) a line up the Tungabhadra to Karwar on the Arabian Sea; and (iv) a line up Ponang, by Palaghat and Coimbatore.' He estimated that a capital outlay of not more than £30,000,000 would be required to construct all the necessary navigable canals. The scheme was suffered to be dropped, however, because of the heavy expenditure it entailed, and even more because it was difficult for Englishmen to understand the value of canals in India, as experience in their own country seemed to decide the case in favour of railways. The opposition on the part of the railways in India was also another factor which counted.

The construction of navigable canals, either in conjunction with irrigation or for transport pure and simple, did indeed appear particularly attractive at a time when the railways were a losing concern. Much of the enthusiasm for it, however, was lost with the turn in the tide and the commencement of railway profits at the beginning of the present century. There are only a few navigable canals today, such as the Ganges Canal from Hardwar to Cawnpore, and the Buckingham Canal parallel to the east coast in Madras. The numerous irrigation canals already referred to are for the most part not suitable as waterways. The two types of canal cannot often be well combined together. Generally speaking, navigation cannot be maintained during the season of short supply of water without detriment to irrigation. Irrigation canals are moreover usually shallow and circuitous in their course and pass through sparsely populated rural regions to serve the needs of cultivation. Canals for navigation must, on the other hand, pass through industrial and commercial centres in order to attract a sufficient volume of business. Conditions are, however, more favourable in the deltaic tracts of Bengal, Orissa, Sind and Madras. In eastern Bengal particularly there is considerable scope for connecting the canals so as to improve the navigation facilities in connexion with its great river system.

In spite of the physical limitations imposed upon inland navigation in India there still appears to be some room for improvement in the existing waterways. The Industrial Commission recommend that the Government of India should take up the question and see to it that the railway and waterway administrations work together harmoniously for those parts of the country which are served by both, and that the proposal of forming a Waterways Trust should receive careful consideration.[1] Inland waterways, properly developed, would relieve any congestion in the railway system and

[1] *Industrial Commission Report*, par. 279.

serve the needs of small-scale transport in the country. It may also be possible to adapt at least some of the irrigation canals to the needs of navigation.[1]

§39. (ii) **Marine transport.**—As regards external water transport, although India does not possess the advantages of England with her indented coastline and natural harbours, she occupies a maritime position of considerable importance. As S. N. Haji remarks: 'A country set like a pendant among the vast continents of the Old World, with a coastline of over 4,000 miles and with a productiveness of numerous articles of great use, unsurpassed elsewhere, is by nature meant to be a seafaring country. Her ports are adequate in size and numbers to meet the various requirements of her products.'[2]

Perhaps the picture is drawn here in excessively bright colours and does not give sufficient weight to India's deficiency of natural harbours. At the same time, as already pointed out, she may well aspire to become one of the principal carriers of the world on account of her extensive seaboard and her favourable position in respect of the rest of the world. Till about the beginning of the nineteenth century, India could be spoken of as a great seafaring country. 'Ship-building was in so excellent a condition in India that ships could be (and were) built which sailed to the Thames in company with British-built ships and under the convoy of British frigates. The Governor-General in 1800, reporting to his masters in Leadenhall Street, London, said: "The port of Calcutta contains about 10,000 tons of shipping, built in India, of a description calculated for the conveyance of cargoes to England." The teakwood vessels of Bombay are greatly superior to the "oaken" walls of old England.'[3]

Speaking of the period at the death of Akbar, Moreland points out that the great bulk of the commerce in the Indian seas was carried in ships built in India, and that India had also great passenger ships much larger than any in contemporary Europe with the exception of the ships built by the Portuguese.

The introduction of iron-built ships, however, deprived India of her differential advantage in respect of plentiful supplies of excellent timber. The rapid improvement in naval architecture and the introduction of mechanized sea transport, the jealousy of the

[1] Mr. Neogy moved in the Assembly in January 1930 the consideration of a Bill to amend the Inland Steam Vessels Act. The amended Act, as passed by the Assembly and accepted by the Government, seeks to develop Indian inland water transport by fixing maximum and minimum rates.

[2] *Economics of Shipping*, pp. 365-6.

[3] Digby, *Prosperous India*, pp. 85-6.

British shipping interests and the operation of the British Navigation Acts, which were applied to India as she came more and more under British control, may be regarded as the chief causes which led to the decay of Indian shipping.[1]

§40. **The difficulties of Indian enterprise in shipping.**—We may now proceed to indicate the position held by Indians in the coastwise and the oceanic trade of India. The total value of our coastal trade in 1935-6 was Rs. 161·85 crores as compared with Rs. 209·29 crores in 1928-9. Rough calculations show that about 5,000,000 tons is annually carried by ships engaged in the coasting trade of India. This volume is capable of further extension if harbour facilities are improved and the co-operation of railways ensured. The growth of an Indian mercantile marine controlled predominantly by Indians ought to stimulate the coastwise trade, as also the present Government policy of improving harbour facilities, evidenced by the schemes of development at Vizagapatam and Cochin.

The total value of the sea-borne trade of India in merchandise and treasure was estimated at Rs. 646·19 crores in 1928-9. It has seriously declined in recent years as we have already seen owing to the economic depression. Its total value in 1936-7 amounted to only Rs. 375·92 crores. Confining ourselves only to the five principal ports of India, namely Karachi, Bombay, Rangoon (before the separation of Burma on 1 April 1937), Madras and Calcutta, where nearly five-sixths of the trade is concentrated, about 12,000,000 tons per year is carried. In spite of this big volume of trade the Indian share in it is almost negligible. It has been estimated that the share of Indians in the coasting trade amounts to only 25 per cent, and in the oceanic trade, only about 2 per cent. In 1936-7 the percentage share of British vessels engaged in the foreign sea-borne trade which entered at ports in British India was 64·7 of the total tonnage. The British Indian share was 0·8 per cent, foreign 33·9 per cent and native craft 0·6 per cent. The corresponding shares of vessels which cleared at ports in British India were 64·8, 1·1, 33·5 and 0·6 per cent respectively.

As the above figures show, even of the paltry two per cent of the trade in the hands of Indians, nearly one-third is accounted for by small native craft. Nor is there any evidence of progress from year to year. All this means the loss of a highly remunerative branch of business to the country. The total shipping earnings have been estimated at Rs. 57 crores, of which 50 crores is carried away by foreign steamship companies (9 crores in coastal

[1] See Digby, op. cit., pp. 87-9 and Malaviya's Minute of Dissent to the *Industrial Commission Report*, pp. 299-300.

traffic, 38 crores in sea-borne traffic and 3 crores in passenger business).[1]

The partial monopoly of the coastal trade which is controlled by a 'Conference' of a few large British navigation companies has created a very uncomfortable position for Indian shippers as well as shipowners. As the substantial profits of over twenty per cent on the paid-up capital earned by these companies, at any rate between 1901 and 1925, show, fairly high freight rates are being charged to the shippers, which ultimately have to be borne by the Indian consumers. Moreover, as the Fiscal Commission point out, the great disparities of rates between the charges on goods shipped from one Indian port to another and those on goods conveyed between India and foreign countries handicap Indian goods in transmission in comparison with goods from and to foreign countries, and neutralize the natural protection which an industry might expect to receive in its own country by reason of the distance of foreign manufacturing centres.[2] But even more serious evils of this foreign control of the coasting trade of India are those connected with the organized and successful attempts made by this Conference to suppress indigenous shipping enterprise in its infancy by methods which may be held to result in unfair or cut-throat competition. The two most important grievances of Indian shipowners are: (i) the deferred rebate system[3] and (ii) rate wars.

§41. **Deferred rebate, rate wars, etc.**—The deferred rebate system has been explained thus: 'The shipping companies issue a notice or circular to shippers informing them that, if at the end of a certain period (usually four or six months) they have not shipped goods by any vessels other than those dispatched by members of the Conference, they will be credited with a sum equivalent to a certain part (usually ten per cent) of the aggregate freights paid on their shipments during that period, and that this sum will be paid over to them, if at the end of a further period (usually four or six months) they have continued to confine their shipments to vessels belonging to members of the Conference. The sum so paid is known as a deferred rebate.'[4] This system is designed to ensure the continued 'loyalty' of the shipper to the Conference, and deprives him of all freedom with regard to the shipping of his goods. It also places a powerful weapon in the hands of the Conference for throttling any indigenous shipping enterprise. The

[1] See Haji, *Economics of Shipping*, pp. 317-32, 375.

[2] *Fiscal Commission Report*, par. 31.

[3] For a fuller description of this system and shipping rings see Haji, op. cit., ch. v.

[4] ibid., p. 126.

Fiscal Commission strongly recommend legislation on the lines followed in other countries against this system. It is not a valid objection against this to point out that the deferred rebate system acts equally powerfully against new competitors of every nationality and not only against those of India. The point is that it hurts Indian shipping seriously. Besides, competitors of other than Indian nationality can usually count on support from their own Government in the form of subsidies and direct bounties for ship-building; their coastal trade also is generally reserved for them.

As regards the British shipping companies, they already occupy a position of substantial, practically unchallenged, supremacy and some of them are further helped by Government patronage in India in respect of mail subsidies and the carriage of Government stores. No such Government assistance has been extended to indigenous shipping. In addition to the deferred rebate system the foreign shipping rings also use another weapon, namely heavily under-selling the Indian competitors with a view ultimately to raising the rates to a higher level than before, after the rivals have been ousted. It is no matter for surprise, therefore, that attempts made by Indian enterprise during the last thirty-five years or so to enter into the promising field of shipping have, generally speaking, ended in irretrievable failure, and most of the companies formed for the purpose have been driven to liquidation. Another handicap under which Indian shipping enterprise is said to labour is the unfair treatment meted out to Indian shipping companies by European insurance companies, who, it is alleged, put into the second class even those Indian ships that are regarded as first-class risks by experts in London, solely on the ground of their Indian ownership.

Other disadvantages of the foreign monopoly in shipping may be briefly noticed. The foreign shipping companies often neglect the comforts of the deck passengers on the coastal ships, and their grievances have formed the subject of inquiries by several Committees. Also, though the crews of the coastal and ocean-going steamers are largely Indian in composition, the number of Indians occupying the higher posts is negligible, and very few of the foreign shipping companies have hitherto shown any readiness to entertain Indian apprentices and afford facilities to them for qualifying as executive officers and engineers on the ships.

§42. **The position of the Indian ship-building industry.**—The Indian ship-building industry is in no better position than Indian shipping. It is stated that the number of ships of a hundred tons gross or over built in the world in the ten years previous to the War was nearly 17,000, their total gross tonnage being something over 28,000,000. These figures will have to be considerably increased to

arrive at the total tonnage of the same description built to date. The total contribution of India, before and after the War, amounts to only twenty-two ships.[1] Competition with non-Indian shipbuilders is only practicable at present for small vessels owing to the cost of bringing out such vessels to India, which is large in proportion to their price. Elsewhere the foreign ship-building yards hold undisputed sway. There are no suitable ship-building yards in India for large ships, and the few repairs shops that exist are controlled by non-Indians.

§43 **The need for an Indian mercantile marine.**—The arguments advanced in favour of extending special protection to these industries aim at showing that they satisfy the conditions laid down under the policy of discriminate protection. Thus it is argued that India possesses undoubted facilities for shipping and shipbuilding, also that elsewhere, for example in Japan, the United States and Germany, State intervention has been the prime factor responsible for endowing these countries with powerful mercantile marines within a remarkably short period. Even England's maritime greatness is often attributed in part to the protection derived from the Navigation Acts, which were in operation for well-nigh two centuries before they were repealed towards the middle of the last century. Lastly, the collapse of most of the attempts made by Indian shipping enterprise to contest foreign monopoly, even in home waters, has been naturally offered as a convincing argument for determined State intervention.

The great need for a mercantile marine in India is easily proved. Apart from the removal of the handicaps already mentioned under which Indian shipowners, shippers and passengers are labouring at present, there are several other positive advantages to be considered. The value of a mercantile marine as a naval auxiliary and a second line of defence in times of war is universally recognized, and as India has now laid the foundation of her own Royal Indian Navy she cannot afford to neglect this aspect of the question. Again, India's coastal and foreign sea-borne trade is sufficiently large in volume to keep an Indian mercantile marine busy. Her dependence on foreign shipping companies—the inconvenience of which was brought home particularly during the War, when there was a great shortage of tonnage—is an element of weakness in her economic position as also in that of the Empire at large. Moreover, the proper development of a mercantile marine will open new avenues of employment to Indians. Navigation, marine

[1] For the various forms of State aid to indigenous shipping and shipbuilding in these and other countries, see Haji's pamphlet, *State-Aid to National Shipping.*

engineering and insurance are highly remunerative branches of business, but today their doors are practically barred and bolted against Indians. The argument that Indians have no aptitude or liking for a sea-going career is unconvincing and is belied by India's record in the past. It is also unfair to urge it since little chance has so far been given to Indians to prove their fitness. It is further useful to remember that, not very long ago, a similar charge used to be made against the Germans, who, as everybody now agrees, are second to none in the qualities required for seamanship. And it is significant that the Mercantile Marine Committee do not anticipate any difficulty in getting educated men of good character as apprentices to the sea if the prospect of ultimate promotion as officers in the mercantile marine is held out to them.

§44. **The Mercantile Marine Committee (1923).**—In response to the persistent agitation in favour of an Indian mercantile marine, the Government at last made a move in the matter, and appointed the Indian Mercantile Marine Committee in February 1923, to consider and report what measures were necessary for the promotion of the Indian shipping and shipbuilding industries. The main recommendations of the Committee may be summed up as follows:—

(i) In order to provide both for the training and future employment of the officers indispensable for the formation of an Indian mercantile marine, a training ship and tender should be established at Bombay by the Government. (The Government accepted this recommendation and the Royal Indian Marine vessel 'Dufferin', refitted so as to enable it to take in cadets, is now being utilized as a training ship for officers and engineers of the Indian mercantile marine.) (ii) For the training of marine engineers provision should be made at the colleges of engineering, and facilities should be given for further experience at sea. (iii) The coastal trade should be reserved for ships which are to arrange for eventual Indianization as regards ownership and controlling interest. This is to be effected by the introduction of a system of licenses or permits as in Australia. The following qualifications should be laid down for eligibility for a license to a shipping company:—(*a*) that it is registered in India, (*b*) that it is owned and managed by an individual Indian or by a joint stock company (public or private), which is registered in India with a rupee capital and with a majority of Indians on its directorate and a majority of its shares held by Indians; and (*c*) that the management of such a company is predominantly in the hands of Indians. (iv) In course of time other conditions should be laid down, for example, that the officers and crews should be entirely Indian, and that the ships applying for licenses should have been built in India. Also, from a certain date to be specified by the Government,

all ships should be required to give an undertaking regarding the employment of Indian apprentices and the gradual Indianization of their officers' and engineers' posts. The licensing authority may also be vested with power to take such steps, with the approval of the Government of India, as may be considered advisable to deal with deferred rates, rate wars or any other conditions which act as an undue restraint on trade. (v) Arrangements should be made by the Government of India to purchase one of the existing British lines operating on the coast as a going concern and appoint directors to control it, the majority of whom should be Indians. Eventually the ownership of vessels in this line should be transferred to approved Indian owners with a view to the concern ultimately being placed in the hands of Indian companies. (vi) The question of granting navigation bounties to purely Indian shipping companies in respect of overseas trade to other countries should be favourably considered as soon as a sufficient number of trained Indian officers are available and Indian shipowners have proved efficient in managing and running coastal steamers. (vii) In case the license system recommended by the Committee is found to be inconsistent with the British Merchant Shipping Act of 1884, resort should be had to a system of bounties on navigation to all Indian-owned and Indian-managed ships, and the grant to them of mail contracts and preference for the carrying of Government stores. (viii) Calcutta should be developed as a centre of self-propelled shipbuilding, being most suitable owing to its vicinity to coal- and steel-producing districts and the greater experience than any other centre which it commands. The Committee recommend that protection should be given to the industry in the form of construction bounties so as to make up the difference between the minimum cost of production in India and abroad, subject to a maximum of twenty-five per cent of the price abroad. (ix) The establishment of a shipbuilding yard by an Indian company[1] may be aided by the Government by (*a*) cheap loans and assistance in acquiring a suitable site; (*b*) extension of Government and Port Trust patronage on certain terms regarding the cost, and (*c*) legal provision that when such a suitable shipbuilding yard is completed and established, all ships seeking a license on the coast should also be required to have been built in India. (x) Expert assistance from abroad for shipbuilding should be invoked to start with. India must, however, establish schools and colleges in the country itself for the study of naval architecture as in England. In this matter she must follow

[1] The late Sir Lalubhai Samaldas preferred that shipyards should be laid out and run by the Government, to be sold later on by tender as going concerns.

Japan and the United States, and Indians should be sent to Britain to take instruction in the schools and shipyards there, so as to enable them to become teachers and leaders in the industry after they return. In the meantime the colleges of engineering should be strengthened and provide for additional post-graduate courses in naval architecture.

§45. **The Bill for reserving coastal traffic for Indian shipping.—** Except for the establishment of the training ship 'Dufferin', the Government failed to give effect to any of the other important recommendations of the Mercantile Marine Committee. Therefore, in the September session of 1928, Mr Haji moved his Bill in the Assembly for the reservation of coastal traffic. This made provision for seventy-five per cent of the stock to be vested in British India Nationals. In the case of a joint stock company, corporation or association, the chairman of the board of directors, and not less than seventy-five per cent of the number of members of the managing firm, and of the directors of the board were to be British Indian subjects. The Bill further laid down that seventy-five per cent of the voting power was to be vested in British Indian subjects. It provided for a system of licenses to be issued by the Governor-General-in-Council for engaging in the coasting trade of India. A five-year period was laid down in the Bill for the gradual reservation of the coastal traffic in the manner above indicated and penalties were provided for the contravention of the provisions of the Bill.

The principle of reservation of coastal traffic contained in the Bill has been adopted by practically all nations aspiring to develop their own mercantile marine, and India naturally desires to take a leaf out of their book in this matter. Too much importance should not be attached to the argument that the Bill involved racial discrimination, because this type of discrimination has come to be regarded as falling within the range of those permissible actions to which a nation has a moral right to resort, although they may be inconvenient to others. Discrimination is essential in order that India's legitimate ambition to have her own mercantile marine should be fulfilled, and, as such, it must be accepted as a disagreeable necessity. While, like every other measure of protection, the reservation of the coastal traffic for Indian ships is bound to be expensive for a time to the country, its justification is the familiar one, namely the confident expectation that protection will before long be unnecessary, for under its influence Indian enterprise will soon be in a position to serve the needs of the country much more effectively than is the case today.

Regarding the treatment of existing vested interests, leaving aside the drastic step of expropriation, one of two methods might be

adopted. Either the existing lines might be bought over by the Government with a view ultimately to handing them over to Indian companies, or they might be offered the option of undertaking gradually to Indianize themselves within a period of five years or so, so as to make them eligible for operating on the coast. The period proposed in the Bill was five years. This provision has been objected to as involving expropriation.[1] Expropriation, however, means deprivation of ownership without adequate compensation, and it may be asked whether it is not too strong a word for withdrawal of trading facilities from a foreign carrier who has been allowed to enjoy them so far as a matter of grace, and who cannot now claim them as a matter of right. A proper respect for vested interests may require some extension of the proposed period of five years, but it cannot, in the long run, prevent the complete reservation of coastal traffic for Indian-controlled vessels. After all, it must be remembered that coasting trade is a domestic preserve under international law, and in this matter Indian interests ought to be considered first and last.

The Coastal Reservation Bill emerged from the Select Committee in April 1929 with certain alterations. The Indian Shipping Conference, which met at Delhi on 3 and 4 January 1930 under the presidency of the Viceroy, and which was attended by the representatives of British and Indian companies engaged in the coastal trade of India, was not able to reach any agreement owing to fundamental differences between the representatives of British and Indian interests. The Government of India took upon themselves the responsibility of determining the future course of action. They subsequently declared that they could not move in the matter until the whole question of discriminatory legislation and the commercial relations between India and Great Britain, which was then before the Round Table Conference, had been decided. The Committee of the whole Conference, at their meeting on 19 January 1931, included the following paragraph in the Report of the Minorities Sub-Committee: 'At the instance of the British commercial community the principle was generally agreed to that there should be no discrimination between the rights of the British mercantile community, firms and companies, trading in India, and the rights of Indian-born subjects, and that an appropriate convention based on reciprocity should be entered into for the purpose of regulating these rights.'[2]

[1] See Sir George Rainy's Minute of Dissent to the Select Committee Report.

[2] *Indian Round Table Conference Sub-Committee's Report*, p. 49.

§46. **The Bill for the abolition of the deferred rebates system.**—Mr Haji also introduced in the Delhi Session of the Assembly (February 1929) a Bill for the abolition of the deferred rebates system in Indian coastal shipping, intended to be complementary to the Coastal Reservation Bill. While this Bill was designed to keep shipping earnings in India, the Deferred Rebates Abolition Bill would ensure a fair distribution of business among the Indian shipping companies once coastal trade was reserved. Mr Haji pleaded that the latter Bill was not to be regarded as contingent on the passing of the former but was required immediately to meet conditions actually prevailing. The abolition of deferred rebates would mean the end of monopolistic shipping combinations whether composed of non-Indian companies or Indian companies or both, and would inaugurate a new era, in which, so far as the coasting trade of India was concerned, an opening would be provided for the entry of new Indian companies by doing away with the existing shipping monopoly. Sir George Rainy, the Commerce Member, criticized the Bill on the ground that it did nothing to stop the rate war and that the deferred rebates system had been helpful in ensuring a regular service, stability of freights and equality between large and small shippers. He suggested that, as in the case of the Straits Settlements, an arrangement should be devised whereby the shippers would be free to leave the Conference once in three years without loss of rebate. The Commerce Member also urged that the Bill should wait at least till the House had decided one way or the other on the Coastal Reservation Bill.

Legislation of the type discussed in this and the previous section will hereafter have to reckon with the provisions with respect to discrimination in the Government of India Act of 1935, which we have already summarized (see vol. I, ch. xiii). Under these provisions it will not be possible to discriminate against British steamship companies operating in coastal waters (see sections 113 and 115 of The Government of India Act, 1935).

As regards the ship-building industry we are in agreement with the recommendations made by the Mercantile Marine Committee to promote it and think that they should be put into execution without any further delay.

§47. **Recent attempts at regulation of coastal traffic.**—Recently (September 1937) a non-official Coastal Traffic Bill introduced in the Central Assembly by Sir A. H. Ghuznavi, was referred to the Select Committee.[1] As the mover pointed out, his Bill did not

[1] A similar Bill moved by Mr P. N. Sapru in the Council of State was rejected by that body about the same time.

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discriminate between British and Indian shipping. Its object was to regulate unfair competition in coastal waters in the shape of rate-cutting or the grant of rebates—a handicap which acts as a deterrent against Indian capital being invested in coastal shipping. The Bill as redrafted by the Select Committee empowers the Central Government to deal with unfair competitive methods in coastal waters, after making inquiries, by fixing the minimum rates of fare and freight for the carriage of passengers and goods. Charging of rates lower than those fixed by the Central Government is made a penal offence. The Government of India are opposed to the Bill on the ground that it is unnecessary and impracticable. Its enactment may be followed by a shipping company mania. On the other hand, they are prepared to regulate coastal shipping within limits. It is understood that they first propose to clear the ground by repealing the old Act of 1850, which threw the coastal waters of India open to the shipping of all nations and then to take powers to regulate coastal shipping. This move is specially directed against the increased intrusion of Japanese and to a lesser extent of German shipping in the coastal trade of India.

CHAPTER VI

THE TRADE OF INDIA

This chapter deals with the trade of India, and for the sake of convenient treatment, the subject may be divided into its main branches as follows:—(i) external trade consisting of (*a*) sea-borne trade, (*b*) entrepôt trade, (*c*) trans-frontier trade; and (ii) internal trade, including inland and coastal trade.

EXTERNAL TRADE

§1. **An historical retrospect.**—The early history of Indian trade may be dismissed briefly, our primary concern being with its development in the modern period since the middle of the last century. There is ample evidence of India's trade relations in ancient times with distant lands. As long ago as 3000 B.C., India had trading connexions with Babylon. Egyptian mummies belonging to 2000 B.C. are supposed to have been found wrapped in Indian muslin of the finest quality. 'There was a very large consumption of Indian manufactures in Rome. This is confirmed by the elder Pliny who complained that vast sums of money were annually absorbed by commerce in India. The muslins of Dacca were known to the Greeks under the name of *Gangetika*.'[1] Among other countries with whom India traded were China, Persia, and Arabia. The trade of India, as indeed all ancient trade, was in rare and costly commodities of comparatively great value in small bulk, in contrast with the present-day trade characterized by transport over large distances of cheap and bulky commodities catering for the needs of the masses. The principal articles of export were textile manufactures, metalware, ivory, perfumes, dye-stuffs, spices, etc. and the imports consisted of minerals, of which there was a deficiency in India, such as brass, tin, lead, and also wines, horses, etc. There was a net import of a large quantity of gold which suggests an excess of exports over imports—a feature which has all along characterized India's trade with other nations. There was also a certain amount of entrepôt trade chiefly in silks and porcelain previously imported from China, in pearls from Ceylon, in precious stones from the Indian archipelago. This entrepôt trade may be taken as a token of India's possession of a fleet of merchantmen.

During the Mohammedan period, which may be said to have commenced from the eleventh century, certain new influences came

[1] Malaviya's Minute of Dissent to the *Industrial Commission Report*, p. 295.

to act upon the foreign trade of India. The early Mohammedan period being more unsettled than the preceding Hindu period must have adversely affected India's trade development. On the other hand, the communications established with India through the north-west frontier stimulated the overland trade of India. As Moreland points out, there were two regular routes on the frontier, from Lahore to Kabul, and from Multan to Kandahar. 'Kabul was a large commercial centre, and a meeting-place for merchants from India, Persia and countries to the north, while it lay on the route from India to the main caravan road between western China and Europe; Kandahar is the doorway from India to the greater part of Persia, and both routes carried a considerable volume of traffic when judged by standards appropriate to the conditions prevailing at the time.'[1] Moreover, the means of transport in the Mogul period were more satisfactory than before. There were a number of fairly good roads. Again, the river-systems of the country, especially in the north, were fully made use of for the purpose of trade, and there was also a brisk commerce on the coastline of India. Moreover, the patronage of the Mogul courts imparted a considerable stimulus to Indian industries, particularly to those which produced luxury goods. The shipping trade was largely controlled by the Moslems, especially on the Malabar coast, and, to a lesser extent, in the Gulf of Cambay and the Coromandel coast, which later came to be largely in the hands of the Banias and Chettiars. Malabar was the great entrepôt for almost the whole trade of the Indian seas coming from the Far East and the Red Sea, Calicut being the principal port for this trade. During the Mohammedan period the general course of trade remained unchanged and 'Gibbon's mordant aphorism "that the objects of oriental traffic were splendid and trifling", is in substance as applicable to the sixteenth as to the second century'.[2] The imports were principally gold, for coinage and display; horses were imported in large numbers; and metals, such as copper, tin, zinc, lead and quicksilver; also luxuries like amber and precious stones. In payment for these imports India sent out her various textile fabrics, dye-stuffs like indigo, opium and other drugs, pepper and a few minor spices, etc.

Towards the end of the fifteenth century came the epoch-making changes in the trade routes owing to the discovery of an all-sea route to India via the Cape of Good Hope, which established the fateful contact between the East and the West. Till then the direct

[1] *India at the Death of Akbar*, p. 219.
[2] ibid, p. 196.

trade with Europe had passed on the Indian Ocean as far as Aden, was then unloaded in the Gulf of Suez and carried by land and water to the Mediterranean Coast. It was thence taken up by the Italian traders of Venice and Genoa, who sent it further west by sea, or to Antwerp by land over the Alps and then down the Rhine, at that period the chief distributor for western Europe. It was the prospect of annexing the large profits of this trade at the cost of their enemies, the Venetians, and of propagating the Christian faith, which inspired the Portuguese quest for a sea route to India. We are not concerned here with the subsequent rivalry among the various powers of western Europe, the Portuguese, the Dutch, the English and the French, nor with the ultimate triumph of the English and the establishment of their power in India. We have already said that it was the linens and calicoes, the jewels and embroideries, woollen and silk manufactures, and not the raw materials, which attracted European traders to India and supplied the basis for the lucrative trade of the East India Company, securing for it the virtual monopoly of trade with the east owing to the elimination of the competition of the French after the Seven Years' War. There was at one time considerable opposition in England to the trade of the Company with India, since Indian imports of calicoes and spices, for which there was an insatiable demand in England, had to be paid for by an export of specie to India,[1] which was a poor market for the English woollens. This agitation became so keen towards the end of the seventeenth century that, from that time onwards, the use of Indian textiles was penalized in England either by complete prohibition, or heavy import duties. We have already stated that the commercial instincts of the East India Company led it at first to encourage Indian industries, on which its export trade depended, but that the pressure of the vested interests in England led to a reversal of this policy in the eighteenth century, and India came to be looked upon primarily as a valuable source of raw materials necessary to develop the manufactures of England, which were rapidly expanding during the period of the Industrial Revolution. We have also referred to the various causes of the decay of the indigenous industries of India and traced the process of ruralization during the latter half of the nineteenth century.

All this did not fail to exercise a far-reaching influence both on the direction and the nature of India's foreign trade. The first

[1] The acquisition of the Diwani of Bengal and the vicious system of investments (purchasing goods for export out of the Indian revenues) considerably reduced the export of bullion to India and lessened the opposition to the Indian trade.

half of the nineteenth century witnessed a remarkable change in the character of the trade between India and England. Henceforward, India began to receive those very commodities as imports which had hitherto bulked so largely in her export trade, namely, cotton manufactures and sugar. The Lancashire cotton industry had so developed that by the middle of the century imports of cotton piece-goods represented about half the total imports of foreign merchandise into India.[1]

§2. **India's trade from 1864-5 onwards.**—The year 1869, when the Suez Canal was thrown open for navigation, marks for all practical purposes the beginning of the modern period in the history of India's trade. The most striking characteristic of this period is the steady growth in the volume of the export and import trade.[2] The following figures (in lakhs of rupees), giving the value of merchandise (including Government transactions) during the last seven years with quinquennial averages for the past seventy years, are of interest in this connexion.[3]

	Imports	Exports	Total
Quinquennial average			
1864-5 to 1868-9	31,70	55,86	87,56
1869-70 to 1873-4	33,04	56,25	89,29
1874-5 to 1878-9	38,36	60,32	98,68
1879-80 to 1883-4	50,16	79,08	1,29,24
1884-5 to 1888-9	61,51	88,64	1,50,15
1889-90 to 1893-4	70,78	1,04,99	1,75,77
1894-5 to 1898-9	73,67	1,07,53	1,81,20
1899-1900 to 1903-4	84,68	1,24,92	2,09,60
1904-5 to 1908-9	1,19,85	1,65,44	2,85,29
1909-10 to 1913-14	1,51,67	2,24,23	3,75,90
1914-15 to 1918-19	1,59,25	2,25,83	3,85,08
1919-20 to 1923-4	2,67,05	3,06,38	5,73,43
1924-5 to 1928-9	2,51,02	3,53,51	6,04,53
1929-30 to 1933-4	1,61,14	1,98,60	3,59,74
In the year			
1930-1	1,73,06	2,26,50	3,99,56
1931-2	1,30,64	1,61,20	2,91,84
1932-3	1,35,02	1,36,07	2,71,09
1933-4	1,17,30	1,51,17	2,68,47
1934-5	1,34,58	1,55,50	2,90,08
1935-6	1,36,77	1,64,60	3,01,37
1936-7	1,27,72	2,02,49	3,30,21

These figures show that exports increased from an average annual value of Rs. 55·86 crores for five years of trade during

[1] C. W. E. Cotton, *Handbook of Commercial Information for India*, p. 95.
[2] The causes of the decline in the value of India's foreign trade in recent years of economic depression are explained below.
[3] *Review of the Trade of India* (1936-7), p. 176.

1864-5 to 1868-9 to 353·51 crores, which was the quinquennial average for the period 1924-5 to 1928-9. During the same period imports rose in value from 31·7 to 251 crores.[1]

The chief causes of this growth may now be briefly indicated. The establishment of peace and order with the practical completion of the British conquest of India by the middle of the last century supplied the much needed security of life and property for the development of commerce. Improved means of communication also opened up the country far and wide for trade. The part played by the railways and roads has already been noticed in the last chapter, to which may be added the influence of the development of telegraphic and postal communications. The most important single cause was the opening of the Suez Canal, which brought India nearer to England by about 3,000 miles. The canal rehabilitated the Mediterranean route to the East and gave new opportunities to countries facing the Mediterranean, such as France, Austria and Italy. The utility of this route was immensely improved by the laying of the submarine cables betweeen Bombay and Suez. This, together with the great improvement in naval architecture and the rapid growth of mercantile marine fostered by various countries, gave a great fillip to India's trade with distant lands and permanently revolutionized its volume and character. The greater part of India's exports came to consist of articles of considerable bulk and comparatively low value, which could now be transhipped cheaply over thousands of miles so as to satisfy the growing international demand for them. Food-stuffs like wheat, rice and tea, and raw materials such as cotton, jute, oil-seeds, hides and skins came to be exported in ever increasing quantities,[2] and they were paid for by the imports of manufactures, such as cotton piece-goods, machinery, hardware, railway materials, glassware, etc., from England, and later from other countries like Germany, the United States and Japan, where striking developments in manufacturing industry were taking place. Another factor which gave an impetus to the trade of India was the adoption of the policy of uncompromising free trade. The numerous internal customs barriers and transit duties which had so long impeded trade were swept away by 1853. The principle of free trade which had carried all before it in England about the middle of the last century

[1] See also *The Economic Resources of the Empire*, edited by W. Worswick, article by H. A. F. Lindsay, the Indian Trade Commissioner.

[2] The agricultural policy of the Government in India was then largely inspired by the idea of stimulating the export of Indian agricultural produce, and the big irrigation schemes undertaken in the Punjab, the United Provinces and Sind were to a large extent in furtherance of this policy.

was applied unhesitatingly to India. Almost all the export duties were abolished by 1874, and the discrimination in favour of British against foreign shipping was removed. Free trade, however, scored its greatest victory when, under pressure from Lancashire, all import duties with a few trifling exceptions were swept away in 1882.[1]

We may in this connexion notice the deliberate and organized efforts made by several countries, such as Germany and Japan, during the twenty-five years or so preceding the outbreak of the War, to establish direct trade relations with India and challenge the predominant position occupied by Great Britain in India's international trade. The large share of the United Kingdom[2] in India's trade during this period is easily accounted for. The establishment of the Company's rule in India, the discomfiture of rival European nations and the use of its political power by the Company for developing its trade in Indian goods have already been noticed. Though the Company's trade monopoly was abolished in 1813 and full freedom was given to all nationalities to establish commercial relations with India, and though all foreign countries were gradually placed on a footing of equality with England in respect of shipping, etc., the British people continued to be in practically monopolistic possession of the field until recently. During this long period the United Kingdom carried on a considerable entrepôt trade in Indian produce, distributing it among other European countries. The investment of British capital in Indian railways and other undertakings and the management of the railways by British companies, British control of shipping and banking, the establishment of trade organizations in the country, such as the British export houses and the European (British) Chambers of Commerce, and the power of directing the fiscal policy of the country, were the principal factors which gave Britain the upper hand.

§3. **The struggle for the Indian market.**—This supremacy began to be gradually undermined in the closing decade of the last century. Germany was the first power to challenge it and was later followed by Japan, whose interest in the trade with India was specially quickened after the Russo-Japanese War. The object of these powers was primarily to push the sale of their manufactures in India. But the organization created for this purpose also served

[1] It is true that the import duties had to be reimposed for revenue purposes in 1894 owing to the fall in the exchange value of the rupee, which subjected the finance of India to a severe strain, but they were maintained at the general low rate of five per cent *ad valorem*.

[2] For statistical details see §12.

to stimulate Indian exports of raw materials and food-stuffs, which these countries required for their own industries. The principal methods adopted for this purpose were: (i) the development of national shipping services, (ii) the establishment of branches of national banks, such as the German Deutsche-Asiatische Bank and the Japanese Yokohama Specie Bank, which offered special credit facilities to their nationals, and (iii) the establishment of foreign commercial houses at the principal centres of trade, like Bombay and Calcutta. It is hardly necessary to point out that this activity had the full sympathy and support of the Governments concerned, and their consulates in India did yeoman service in fostering their country's trade with India. The United States, however, was for a long time content to deal with India through London, and her efforts to promote direct trade relations were until after the outbreak of the War not so conscious and determined as those of Germany and Japan.[1]

§4. **The pre-War position summarized.**—The combined effect of all the factors noticed above was seen in an enormous growth of the export and import trade of India, though the figures given show that the growth did not take place at a uniform pace throughout the period reviewed. Up to 1873, there was a heavy increase in exports, especially between 1864 and 1869 owing to the American Civil War which led to large exports of cotton at high prices from India, while it checked the imports of piece-goods into the country owing to the difficulties of England in obtaining the usual supply of raw cotton. Between 1873 and the end of the century trade development was comparatively slow.[2] This was largely due to certain special factors. In the first place, the rupee had been steadily losing its gold value, and fell from two shillings in 1872 to about fourteen pence in 1893. The violent oscillations in the value of the rupee introduced an element of uncertainty and speculation in the foreign trade with gold standard countries and served to check its normal growth. Moreover, the famine of 1876-8 and the two others which occurred at the end of the century, and the repeated visitations of plague, which first appeared in Bombay in 1896, aggravated the situation. Lastly, while the successful

[1] The languid interest of France in Indian trade is accounted for by the fact that her exports consisted mostly of luxury articles for which there was no large demand in India. See R. M. Joshi, *Indian Export Trade*, ch. vii.

[2] Joshi shows (op. cit., p. 8) that between 1834 and 1855 exports rose from 8 to 23 crores of rupees, and between 1855 and 1873 from 23 to 60 crores. Between 1873 and 1893, the rise was only from 60 to 100; then till 1899 there was practically no rise at all; and it was only between 1899 and 1914 that there was the striking rise from 100 to 203 crores of rupees.

stabilization of the rupee at 1*s.* 4*d.* between 1898 and 1914 smoothed the course of India's trade with gold standard countries, the appreciation of the rupee contributed, to some extent, as we have already seen, to the loss of trade in textiles with Japan and China.

The first fourteen years of the new century witnessed a remarkable expansion of the foreign trade of India, especially after 1905. The largest increase was revealed by the five years preceding the War, for which the average was Rs. 224·23 crores for exports, and 151·67 for imports, as against Rs. 124·92 crores for exports and 84·68 for imports during the five years from 1899-1900 to 1903-04. During these years the rupee was almost stable, public works such as railways and irrigation were being pushed forward with vigour, there were no serious famines such as those at the end of the previous century, and the virulence of plague was decreasing. Moreover, as already stated, Germany and Japan, and to a lesser extent the United States, were making organized efforts to push their trade, which was fast expanding under the stimulus of the economic transformation which they were undergoing, bringing them into line with England as industrial nations.

§5. **Effects of the War on India's trade.**—The following tables[1] bring out the effects of the War on India's trade.

TABLE I

Value (in millions of pounds) of the overseas trade in total merchandise

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127·5	96·5	92·1	106·8	109·6	125·7
Exports	166	121·4	133	167·9	163·3	170·2

TABLE II

Value (in millions of pounds) of the overseas trade (total merchandise calculated at the prices current in 1913-14)

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127·5	95·6	73·1	62·8	51·9	46·9
Exports	166	119	129·1	140·9	130·6	113·5

[1] See S. G. Panandikar, *The Economic Consequences of the War*, pp. 44-5.

In order to ascertain the effects of the War on the volume of trade it is necessary to take into consideration the rise in prices which took place during the War years. This particularly applies to the imports, which rose in value much more than the exports. Taking the prices of exports and imports in 1913-14 as 100, while the prices of imports rose to 268, those of exports rose only to 150 in 1918-19. Even taking into consideration only the recorded values of exports and imports, Table I above shows that both the branches of foreign trade received a set-back on the outbreak of the War and that, while the value of the exports recovered from 1916-17 onwards, that of imports lagged behind the pre-War year even so late as in 1918-19. Table II, however, shows that there was a far more serious reduction in the volume of trade, especially of the import trade, which declined continuously throughout the War years. We may now briefly examine the causes which brought about this state of affairs. The War led to a complete cessation of trade with the enemy countries. The discontinuance of trade with Germany was particularly serious, for she had been India's best customer after Great Britain in the pre-War period. At the same time the trade with the allied countries, like Great Britain, France, and Belgium, could not be maintained at the pre-War level owing to their preoccupation with the War. Trade with neutral countries was subjected to restrictions calculated to prevent munitions of war from India reaching Germany through such countries and to make Indian supplies solely available for the Allies. A more distressing factor was the sharp rise in freights as a result of the disappearance of enemy tonnage from the high seas and the pressure of war requirements on the remainder available. The tonnage difficulty particularly affected India owing to her being separated by a greater distance from western Europe than other suppliers of raw materials to Europe like the Argentine, Brazil, Canada, and the United States of America. This factor largely discounted the advantage which India might otherwise have derived from the great demand in Europe for her commodities. The dislocation in the foreign exchanges and the insecurity on the sea owing to the destructive activity of the 'Emden' and the 'Königsberg' were also factors which disturbed the course of trade. The country, however, soon began to adapt itself to war conditions. Large quantities of sandbags for trench warfare and hides for the manufacture of boots for the soldiers were required, and this greatly stimulated the exports. The export trade would have shown an even larger increase had it not been for the difficulties regarding export finance arising from the curtailment of the sale of Council Bills, and from Government control. Though the import trade did not experience the same

revival, the gap caused in the Indian market was partly filled up by increased imports from the United States and Japan, who fully exploited the situation so created to their own advantage. Thus the War affected Indian trade more adversely than the trade of some other countries like Japan. 'While India's trade was painfully endeavouring, till the cessation of the hostilities, merely to recover from the adverse effects of the War, making it futile to expect its expansion, Japan's export trade had more than trebled and her import trade had increased 2½ times by the time of the Armistice.'[1]

One welcome feature, however, of India's War-time foreign trade was the increase in the exports of manufactures, whose percentage to the total export trade rose from 22·4 per cent in 1913-14 to 36·6 per cent in 1918-19, though much larger increases were recorded in the case of other countries like Canada. The artificial stimulus given by the War to Indian industries like cotton, jute, leather, steel and iron has already been noticed, and this accounts for the increase in the exports of manufactures, which, however, might have been much higher if India had been fully prepared to take advantage of the temporary disappearance of foreign competition in her markets. It is necessary in this connexion to supply a corrective to the common notion that the War brought immense prosperity to India. The abnormal increase in her favourable balance of trade was not an unmixed blessing. It had, for instance, the effect of inflating the currency by the addition of a large volume of paper money and rupee coinage.[2] The enforced reduction in imports occasioned very serious inconvenience, and though a few traders, especially in capital towns, seemed to be making more money than they quite knew what to do with, there is no proof of a general rise in the standard of life and it is quite certain that the phenomenal rise in prices adversely affected a large number of people.[3]

§6. **Post-War trade from 1919-20 to 1936-7.**—The figures below may serve as an introduction to a discussion of the post-War developments in trade.

As in a number of other countries, so in India, the early post-War period was characterized by a trade boom caused by the removal of many of the War-time prohibitions on exports, as well as a gradual resumption of commercial intercourse with enemy countries accompanied by an improvement in the freight position.

[1] Panandikar, op. cit., p. 55.

[2] For a fuller treatment of the question see ch. vii.

[3] See Panandikar, op. cit., pp. 46-7.

Value (in crores of rupees) of sea-borne trade in total merchandise (including Government stores)

Year	Imports	Exports	Net Exports	Year	Imports	Exports	Net exports[1]
1919-20	221·70	336·02	+114·32	1928-9	263·4	339·15	+75·75
1920-1	347·56	267·76	− 79·80	1929-30	249·71	318·99	+69·28
1921-2	282·59	248·65	− 33·94	1930-1	173·06	226·50	+53·44
1922-3	246·19	316·07	+ 69·88	1931-2	130·04	161·20	+31·16
1923-4	237·18	363·37	+126·19	1932-3	135·02	136·07	+ 1·05
1924-5	253·37	400·24	+146·87	1933-4	117·31	150·23	+32·92
1925-6	236·00	386·82	+150·82	1934-5	134·59	155·04	+20·45
1926-7	240·82	311·05	+ 70·23	1935-6	134·43	164·29	+29·86
1927-8	261·53	330·26	+ 68·73	1936-7	125·24	202·37	+77·13

There was also a brisk demand for Indian produce on the part of the Western countries for the reorganization of their industries. The revival of trade, especially on the side of exports, would have been even more striking but for the railway congestion in India, high prices, labour troubles, unstable foreign exchanges, the rise in the exchange value of the rupee and the continuation of the restrictions on the export of cereals owing to the failure of the monsoon in 1918-19. Even as it was, however, the pace of the post-War boom was too fast and it was inevitable that before long it should be succeeded by a slump, indications of which were clearly apparent in the latter part of the year 1920-1. The export trade was the first to be affected. The markets of Great Britain, the United States and Japan, who were all among India's best customers, were glutted with Indian produce, and there was a considerable slackening of the demand on their part. The countries of central Europe, which had been a valuable market for Indian exports during the pre-War period, no doubt badly wanted Indian products, but could not buy them owing to their shattered resources and reduced purchasing power. The continuous inflation of their currencies and their unexampled depreciation in terms of foreign currencies, combined with their inability to command credits abroad, made matters still worse for them. The unsatisfactory rains of 1920 in India and the high prices of food-stuffs necessitated the continuance of the embargo on the export of food-stuffs. There was also a severe crisis in Japan which checked the exports of

[1] The net exports (excess of exports over imports) of private merchandise (sea-borne trade), *excluding* Government stores, for the last seven years were as follows: Rs. 61 crores in 1930-1, Rs. 34 crores in 1931-2, Rs. 3 crores in 1932-3, Rs. 35 crores in 1933-4, Rs 23 crores in 1934-5, Rs. 31 crores in 1935-6 and Rs. 78 crores in 1936-7.

Indian cotton to that country. The ill-fated attempts of the Government to stabilize the exchange value of the rupee at 2*s.* (gold), on the recommendation of the Babington-Smith Committee,[1] further paralysed the already weak export trade. The import trade, on the other hand, expanded rapidly. India's import requirements had been starved during the War and orders had been placed for machinery and other manufactured goods during the War and after the Armistice for delivery at the discretion of the manufacturers, and these now began to pour into the country. The high exchange also gave a powerful stimulus to the import trade and orders were placed for immense quantities of foreign manufactured goods. It is no matter for surprise, therefore, that there was a heavy balance of trade against India, to the extent of Rs. 79·80 crores in 1920-1, which continued into the next year when it amounted to Rs. 33·94 crores. The year 1921-2 was one of unrelieved depression, when heavy losses were incurred by the importers as a result of the collapse of the rupee and the failure to stabilize it at 2*s.* (gold).

After the year 1922-3 a recovery was discernible. And at least so far as the import trade was concerned, the trend towards the restoration of normal conditions was continuously in evidence till the year 1929-30. The conditions which favoured the progress towards gradual recovery were the progressive stabilization of the European currencies, the improvement in the credit position of the central European countries, and the apparent settlement of the reparations question by means of the Dawes Scheme in 1924. The League of Nations, it may be noted here, played a beneficent part in hastening the progress of restoration, for example, by helping Austria and Hungary in the work of currency stabilization. In spite of the amendment of the situation, however, it never became entirely satisfactory, owing, among other things, to the fact that the international financial problem still dominated the situation, and Europe was not yet rid of her War-time legacies of tariff barriers, with rapid fluctuations in the tariff rates and the contraction of credit, of production and of purchasing power. Economic conditions in foreign countries were, nevertheless, becoming more stable; for example, during the year 1927-8 Great Britain recovered from the depressing effects of her prolonged coal strike, Italy returned to the gold standard, and the French exchange was virtually stabilized. This advance continued into the year 1928-9, only to be followed, however, by a depression world-wide in scope and unprecedented in magnitude.

[1] See ch. vii.

§7. **India's trade during the world economic depression.**—A downward trend of trade started in October 1929, after the Wall Street collapse, and afterwards spread to most other countries all over the world. The main causes of this trade depression, which dominated India's foreign trade during the years 1929-30 to 1933-4, may be summed up as follows:—(i) overproduction in comparison with the normal rate of consumption in the case of both raw materials and manufactured products, but particularly in the case of the former; (ii) monetary causes, especially the concentration of gold in America and France resulting in a depletion of the reserves of the Central Banks in other countries and the consequent deflationary policy followed by these banks until the suspension of the gold standard in September 1931 by Great Britain, whose example was followed by India and a large number of countries; (iii) political unrest in many quarters of the globe, notably in India, China and South America and subsequently in other countries. Restrictions on trade in the shape of tariffs, quotas, exchange control, etc., which became numerous during the era of exchange instability ushered in by the widespread abandonment of the gold standard, further adversely affected world trade. All these factors gave a setback to the foreign trade of India—a fact clearly brought out by the tables on pp. 237 and 243 and tables I to IV on pp. 244-7. The fall in the value of exports was mainly due to the disastrous fall in the prices of agricultural raw materials[1] and the decline in the foreign demand for India's staple exports. The fall in the value of imports was largely the result of the reduced purchasing power of the consumers in India, the tense political situation in the country and the extension of home production of cotton textiles and sugar stimulated by the policy of discriminate protection India has followed since 1924.

The fall in the case of exports was naturally far greater than in the case of imports owing to the fact that the prices of agricultural commodities and raw materials, which form the bulk of India's exports, fell to a much greater extent than the prices of manufactured goods which form the bulk of Indian imports. Had it not been for the enormous quantity of gold exported from India after Great Britain went off the gold standard, the balance of trade in favour of India would have dwindled to a negligible figure indeed.[2] The slump in the export trade was at its worst in 1932-3, when the value of the exports dropped to Rs. 136 crores,

[1] See ch. ix.

[2] See §16 and also ch. viii.

and the visible balance of trade in merchandise was only Rs. 3 crores, the smallest figure on record. The worst phase of the world depression came to an end in 1932, and the early months of 1933 had seen a considerable revival of business activity in several countries under the stimulus of devaluation and cheap money conditions. At the same time the prevalent urge towards economic nationalism, under the influence of which each country was trying to reserve its markets for its own nationals, and the failure of the World Economic and Monetary Conference, held in London (1933), owing to the hostile attitude of the United States of America towards the stabilization of world currencies, handicapped recovery of world trade.

The great American experiment of socialization of finance and industry, undertaken in the Recovery Plan of President Roosevelt, while it exercised a certain beneficial influence on world prices, obscured the beginning of a genuine rise in world prices of commodities by the greater speculative rise based on the prospect of inflation in America. The period of dollar uncertainty probably enhanced the difficulties in the path of increased international trade. The Recovery Plan in some ways accentuated existing uncertainties and disturbed existing channels and accustomed modes of business. The history of the past few years suggests that measures of internal reconstruction are successful only to a limited extent in stimulating economic recovery. Nevertheless, on the whole, there were feeble indications in the year 1933-4 that the corner was about to be turned and that at least some recovery had at last been made from the depression. In India the year 1933-4 was the first complete year after the introduction of the preferential duties resulting from the Ottawa Agreement made by the Government of India with His Majesty's Government in the United Kingdom at the Imperial Economic Conference held at Ottawa during July-August 1932. (See Chapter XIII for the examination of the effects of that Agreement.) Apart from the Ottawa Agreement, the outlook in India was considerably changed by some recent legislation (see Chapter II above) intended to deal with the intense competition from Japan. Of the greatest importance was the conclusion of a new Trade Agreement with Japan which came into force early in 1934. (See Chapter XIII.) Closely associated with this development were the unofficial negotiations which resulted in what is known as the Mody-Lees Pact which is reviewed in the concluding chapter. In 1933-4 Indian conditions generally showed some progress towards recovery so far as the export trade and the visible balance of trade were concerned, although agricultural conditions remained much the same.

§8. **World economic recovery and India's trade.**—The years 1934-5, 1935-6 and 1936-7 were marked by further progress in the process of economic recovery. In the earlier stages, the improvement was confined to particular countries or industries, but in 1936 the world appeared to have definitely emerged from the paralysing conditions of the great depression. The gradual depletion of stocks of primary commodities since 1934, the restriction schemes for regulation of production of various commodities adopted on a voluntary basis by some of the chief producers, the collapse of the gold bloc under the leadership of France, and the devaluation of the erstwhile gold currencies in September 1936, brought about a rise in the prices of many commodities. The rise became striking during the first half of 1937, owing to the influence of an additional factor, namely the heavy government expenditure on armaments in many countries, which gave a great stimulus to the heavy industries, and had an exhilarating effect on the general economic situation. The recovery being, however, still mainly national in character, did not lead to a similar advance in international trade, which was 15 per cent less in volume in 1936-7 as compared with 1929. Conditions of international trade were no freer than at the bottom of the depression when such devices as high import tariffs, quotas, clearing agreements, and other measures regulating trade were adopted by several countries, notably by Germany and Italy. In fact, the increasing tendency towards bilateralism is one of the marked features of world trade during the last few years. In recent times, especially since the devaluation of continental currencies, the movement towards freer trade and the removal of artificial barriers has gained greater popularity and strength, especially in the three leading democracies of England, America and France, but still there have been few tangible results of this change in opinion.[1]

India followed the general world trend towards recovery, although owing to her special conditions, her course of recovery was somewhat different from that of other countries. In spite of rapid industrialization of recent years, she still remains predominantly an agricultural country, and the economic welfare of the people depends largely on agricultural conditions in India as well as abroad. The depression which started in 1929 hit agricultural countries like India with special severity, owing to the unprecedented fall in the prices of primary produce. Although the improvement in agricultural prices began somewhat previously, it was only during 1936-7 that there was an appreciable advance in the prices

[1] *Review of the Trade of India* (1936-7), pp. 1-2.

of India's agricultural products. (See also ch. x.) Prices even in that year were, however, much lower in the case of most commodities than in 1928-9. This marked improvement was chiefly the result of a general recovery in the demand for primary commodities and raw materials. The gradual rectification of the disparity between the industrial and agricultural prices, which was particularly marked after the middle of 1936, has had a beneficial effect on the economic conditions of agricultural countries like India. India's trade, especially her export trade, in consequence made a considerable recovery, especially in 1936-7 when it recorded an advance of nearly Rs. 36 crores over the previous year's total. In the same year the trade balance in private merchandise in favour of India, which had sunk to only Rs. 3 crores in 1932-3, mounted to Rs. 78 crores.[1] As compared with 1928-9, the pre-depression year, exports (Rs. 1,96 crores) in 1936-7 still showed a deficit of Rs. 1,34 crores or 41 per cent. This enormous shrinkage was almost entirely due to the decline in prices of exported articles, which amounted to 41 per cent in 1936-7 as compared with 1928-9. The quantum of exports in 1936-7 was slightly higher than in 1928-9. Imports on the other hand were valued at Rs. 1,25 crores in 1936-7 as compared with Rs. 1,34 crores in the preceding year. As against 1928-9, when the value of imports was Rs. 2,53 crores, the fall in the year 1936-7 amounts to 51 per cent: only a part of this shrinkage, however, is due to the decline in prices. As compared with 1928-9, the decrease in import prices was only about 35 per cent and there is little doubt, therefore, that the quantum of imports, unlike exports, has been reduced considerably as compared with the pre-depression level.

§9. **The quantum of trade of India.**—The above conclusion is borne out by the table given below. To illustrate the variations in the quantum of trade the values of imports and exports of merchandise have been compiled on the basis of declared values per unit in 1927-8 and are shown below. Changes in the price levels of imports and exports in relation to 1927-8 are also indicated by means of index numbers obtained by comparing the figures with the actually recorded values each year. These statistics, although

[1] The export trade of India received a setback in the year 1937-8, especially during the latter part of the year, owing partly to the effects of the Sino-Japanese conflict on India's export trade with Japan and partly to the reactions on India of the general 'recession'. The very serious drop in the world price of cotton also contributed to the same result. In consequence the trade balance was curtailed as compared with that in the preceding year.

necessarily approximate, afford a rough measure of the course of India's trade and prices.

Year	Quantum of		Price-Level of	
	Exports	Imports	Exports	Imports
	Rs. (crores)	*Rs. (crores)*		
1927-8	319·2 (100·0)	249·8 (100·0)	100·0	100·0
1928-9	338·6 (106·1)	262·8 (105·2)	97·5	96·4
1929-30	344·6 (108·1)	258·4 (103·4)	90·2	93·2
1930-1	308·4 (96·6)	206·0 (82·5)	71·5	80·0
1931-2	263·3 (82·5)	176·3 (70·6)	59·2	71·7
1932-3	239·2 (74·9)	203·4 (81·4)	55·3	65·2
1933-4	275·2 (86·2)	181·7 (72·7)	53·5	63·5
1934-5	280·4 (87·8)	210·0 (84·1)	54·1	63·0
1935-6	282·1 (88·4)	216·4 (86·6)	56·9	62·1
1936-7	342·9 (107·4)	199·4 (79·8)	57·2	62·8

This table shows that the quantum of India's exports, having increased by nearly 8 per cent between 1927-8 and 1929-30, naturally declined when the depression started in October 1929, the lowest point being reached in 1932-3; when it was 75 per cent of the level of 1927-8 and about 71 per cent of that of 1928-9. From 1933-4, it steadily rose, the increase being particularly remarkable in 1936-7, when it was greater than in 1928-9 by 1 point and was only half a point less than in 1929-30. The quantum of imports rose by 5 points in 1928-9 as compared with the preceding year. In 1931-2 it was 29 per cent less than in 1927-8. In 1932-3, there was some revival of the import trade, but in the next year, it again declined and was only slightly higher than the lowest point reached in 1931-2. During 1934-5 and 1935-6, the quantities imported into India were on a much higher level, being 84 and 87 per cent of 1927-8. There was a set-back in 1936-7 again, and the quantum of imports was only 80 per cent of that in the base year.[1]

§10. **Characteristics of India's sea-borne trade.**—We may now proceed to examine the principal characteristics of India's sea-borne trade. Tables I and II below mention the value of imports and exports of private merchandise according to five main classes; while tables III and IV show the comparative importance of the

[1] *Review of the Trade of India* (1936-7), p.29.

principal articles imported into and exported from British India respectively.

TABLE I (Imports)[1]

In crores of rupees

		Pre-War average	War average	Post-War average	1935-6	1936-7
I.	Food, drink and tobacco	21·8	26·4	37·8	13·2	11·1
II.	Raw materials, produce and articles mainly unmanufactured	10·1	9·9	19 0	19·2	19·4
III.	Articles wholly or mainly manufactured	111·8	108·2	192·6	99·4	92·4
IV.	Living animals	0·4	0 5	0·2	0·2	0·2
V.	Postal articles not specified	1·7	2·8	4·4	2·4	2·1
	Grand Total ...	145·8	147·8	254·0	134·4	125·2

TABLE II (Exports)[2]

In crores of rupees

		Pre-War average	War average	Post-War average	1935-6	1936-7
I.	Food, drink and tobacco	63·0	59·6	59·7	37·1	40·2
II.	Raw materials, produce and articles mainly unmanufactured	104·6	86·4	145·9	79·2	102·6
III.	Articles wholly or mainly manufactured	50·6	68·4	77·9	42·2	49·8
IV.	Living animals	0·3	0·2	0·3	0·1	0·1
V.	Postal articles	0·9	1·3	2·5	1·9	3·4
	Grand Total ...	219·4	215·9	286·3	160·5	196·1

[1] *Review of the Trade of India* (1936-7), pp. 178-9.

[2] ibid., pp. 180-1.

Tables I-IV illustrate numerically the oft-repeated statement that the bulk of the exports from India consist of food-stuffs and raw materials and the bulk of the imports, of manufactured articles. We have already explained above how this characteristic of India's present-day trade stands in marked contrast with her foreign trade up to the opening decades of the last century, and also the process of the transition from the one to the other. We have also discussed the question relating to the policy to be followed with regard to the export of food-stuffs and raw materials from the country.[1] Similarly, in the preceding chapters hardly a single opportunity has been lost of insisting with all possible emphasis on the desirability of rapid industrial development in the country so as greatly to reduce our present dependence on foreign manufactures.

Even long before the War, a slight improvement in this direction had taken place and the percentage of exports of manufactures to the total exports had shown a tendency to increase gradually, though the bulk of the exports, then as now, were in the form of raw materials and food-stuffs. During the War period, for reasons already explained, this percentage showed an appreciable increase from 22·4 in 1913-14 to 36·0 in 1918-19.

In spite of some improvement, however, it is clear that the salient features of the trade of India remain essentially as described above. For example in 1936-7, 73·9 per cent of the imports consisted of wholly or partly manufactured articles and about 72·9 per cent of the exports consisted of raw materials and food-stuffs.

§11. **Broad analysis of imports and exports (1935-6 and 1936-7): (i) Imports.**—It will be seen from table III above that cotton and cotton goods hold the place of honour on the import side, though the percentage proportion to total imports has fallen from the quinquennial pre-War average of 36 per cent to 20·76 per cent in 1935-6 and to 18·63 per cent in 1936-7. In chapter II we have already explained the causes of the very appreciable decline in the imports of cotton piece-goods. The total value of imports of cotton manufactures in 1936-7 dropped to nearly Rs. 18 crores from the preceding year's figure of Rs. 21½ crores. Both the yarn and piece-goods section shared in the general decrease. Imports of cotton twist and yarn during 1936-7 were valued at Rs. 2,55 lakhs; the quantity which this value represented was 28·5 million lb. Compared with the preceding year, there was a decrease of about 16 million lb. or 36 per cent in quantity and Rs. 1,16 lakhs, or 31 per cent in value. The decrease was mostly in evidence in the imports of grey yarns, while those of white, coloured and

[1] See vol. I, ch. vi.

TABLE III (Imports)

The following table[1] shows the comparative importance of the principal articles imported into British India in 1936-7 and five previous years.

In lakhs of rupees

	1929-30	1932-3	1933-4	1934-5	1935-6	1936-7	Percentage on total imports of merchandise in 1936-7
Cotton and cotton goods	62,90	34,08	21,30	27,05	27,90	23,33	18·63
Machinery and mill-work	18,22	10,54	12,77	12,63	13,68	14,14	11·29
Metals and ores	23,62	9,73	9,50	11,38	12,03	9,69	7·73
Oils	11,68	8.00	6,75	6,97	7,25	7,25	5·79
Vehicles	10,85	3,82	4,77	6,60	6,92	6,58	5·25
Instruments, apparatus and appliances	5,38	3,85	4,02	4,73	5,18	5,19	4·15
Artificial silk	...	4,16	2,74	3,59	3,16	3,86	3·08
Provisions and oilman's stores	5,64	2,93	2,72	2,89	3,12	3,20	2·56
Dyes	2,43	2,50	2,46	3,08	3,34	3,01	2·41
Hardware	5,07	2,99	2,88	3,05	3,27	2,89	2·31
Wool, raw and manufactured	4,28	2,96	2,55	3,86	2,79	2,87	2·29
Paper and pasteboard	3,72	2,86	2,63	2,73	2,99	2,82	2·25
Chemicals	2,79	2,71	2,70	2,92	3,12	2,72	2·17
Silk, raw and manufactured	4,58	4,33	3,59	3,37	2,78	2,42	1·93
Liquors	3,77	2,26	2,27	2,36	2,48	2,40	1·91
Rubber manufactures	3,33	1,98	1,88	2,06	2,07	2,11	1·69
Drugs and medicines	2,26	1,86	1,93	1,92	2,11	2,07	1·65
Spices	3,26	1,73	1,56	1,55	1,62	1,88	1·50
Fruits and vegetables	1,83	1,17	1,00	1,30	1,33	1,42	1·13
Glass and glassware	2,52	1,42	1,22	1,33	1,39	1,28	1·02
Precious stones and pearls, unset	1,10	84	75	50	48	98	0·78
Paints and painters' materials	1,47	92	92	97	1,02	97	0·77
Tobacco	2,70	97	72	62	62	81	0·65
Manures	99	53	52	67	71	80	0·64
Apparel	1,71	84	82	82	71	80	0·64
Stationery	1,05	72	66	69	76	75	0·60
Grain, pulse and flour	5,42	71	84	2,66	1,62	72	0·57
Building and engineering materials	1,34	77	64	60	73	67	0·54
Toilet requisites	73	58	57	64	66	67	0·54
Arms, ammunition and military stores	65	44	43	43	49	66	0·53
Haberdashery and millinery	1,04	68	55	67	59	64	0·51
All other articles	44,47	8,70	16,70	17,65	17,51	15,64	12·49
Total value of imports ...	240,80	132,58	115,36	132,29	134,43	125,24	100

[1] *Review of the Trade of India* (1920-30 and 1936-7).

TABLE IV (Exports)

The following table[1] shows the comparative importance of the principal articles exported from British India in 1936-7.

In lakhs of rupees

	1929-30	1932-3	1933-4	1934-5	1935-6	1936-7	Percentage on total exports of merchandise in 1936-7
Cotton, raw and waste	65,60	20,70	27,91	35,45	34,47	45,17	23·03
Cotton manufactures	7,19	3,29	2,73	2,65	2,93	3,78	1·93
Jute, raw	27,17	9·73	10,93	10,87	13,71	14,77	7·53
Jute manufactures	51,93	21,71	21,37	21,47	23,49	27,95	14·25
Tea	26,00	17,15	19,85	20,13	19,82	20,04	10·22
Seeds	26,47	11,31	13,66	10,54	10,33	18,47	9·42
Grain, pulse and flour	34,79	16,08	11,75	11,84	12,41	15,38	7·84
Metals and ores	10,34	4,68	5,49	5,91	7,73	8,02	4·09
Leather	8,16	4,76	5,83	5,48	5,63	7,36	3·75
Hides and skins, raw	7,98	2,77	4,25	3,13	4,13	4,43	2·26
Wool, raw and manufactured	5,33	1,78	2,72	2,19	2,93	3,74	1·91
Lac	6,97	1,24	2,46	3,30	1,58	2,34	1·19
Oil-cakes	3,12	1,97	1,65	1,97	1,82	2,27	1·16
Paraffin wax	3,18	2,02	2,29	1,92	2,28	1,96	1·00
Wood and timber	1,80	56	84	1,10	1,35	1,77	0·91
Fruits and vegetables	91	70	99	1,08	1,65	1,70	0·87
Rubber, raw	1,79	9	31	66	89	1,04	0·53
Fodder, bran and pollards	1,19	70	47	77	73	96	0·49
Mica	1,03	32	45	69	83	94	0·48
Tobacco	1,06	77	94	82	92	93	0·47
Coffee	1,45	1,10	1,02	73	1,02	84	0·43
Coir	1,05	60	77	80	88	71	0·36
Oils	72	54	57	55	64	70	0·36
Hemp, raw	68	32	36	39	60	69	0·35
Dyeing and tanning substances	1,12	75	79	72	70	64	0·33
Spices	1,96	72	72	77	55	55	0·28
All other articles	11,81	5,91	6,13	5,74	6,50	8,97	4·56
Total value of exports ...	310,80	132,27	147,25	151,67	160,52	196,12	100

[1] *Review of the Trade of India* (1929-30 and 1936-7).

mercerized yarns showed comparatively smaller decreases. Imports of raw cotton dropped from 77,000 tons valued at Rs. 6,74 lakhs in 1935-6 to 65,000 tons valued at Rs. 5,85 lakhs in 1936-7. This import is necessitated by home production of yarn of higher counts, for which the finer long-staple cotton has to be imported.

Next in importance to the imports of cotton and cotton manufactures are machinery and mill-work, metals and ores. The imports of machinery and mill-work (which since April 1928 include railway locomotive engines, tenders and parts) were valued at Rs. 14,14 lakhs in 1936-7 as compared with Rs. 13,68 lakhs in 1935-6. Imports of metals and ores declined from Rs. 12,03 lakhs in 1935-6 to Rs. 9,69 lakhs in 1936-7. Iron and steel manufactures accounted for 360,000 tons valued at Rs. 5,93 lakhs in 1936-7 as compared with 446,000 tons valued at Rs. 7,20·5 lakhs in 1935-6. The imports of other metals such as aluminium, brass, copper, lead, tin, zinc, German silver, etc. declined from 84,000 tons valued at Rs. 4,80 lakhs in 1935-6 to 61,000 tons valued at Rs. 3,73 lakhs in 1936-7. Our imports of sugar, which not long ago held the second place, i.e. to piece-goods, now occupy a secondary place in the import trade, owing to the rapid expansion of the home industry following the grant of protection in 1931-2. (See Vol. I, ch. vi.) Imports of sugar of all sorts amounted to 1,012,000 tons valued at Rs. 15,77 lakhs in 1929-30. The quantity imported declined to 201,000 tons and its value to Rs. 1,91 lakhs in 1935-6. In the year 1936-7 there was a sharp decline, the quantity imported being only 23,000 tons valued at Rs. 24 lakhs. Other articles of considerable importance are oils (valued at Rs. 7,25 lakhs in 1935-6 and Rs. 7,25 lakhs in 1936-7); vehicles, especially motor vehicles (valued at Rs. 6,92 lakhs in 1935-6 and Rs. 6,58 lakhs in 1936-7); instruments and apparatus, artificial silk, provisions and oilman's stores, dyes, hardware, wool—raw and manufactured, paper, chemicals, silk—raw and manufactured, liquors, rubber manufactures, etc.

(ii) Exports.—On the export side, as table IV above shows, cotton and jute are the most important commodities. The exports of Indian cotton in 1936-7 totalled 4,268,000 bales as compared with 3,397,000 bales in the preceding year. Japan, as usual our best customer, took 2,426,000 bales or 667,000 more than in 1935-6. It is interesting to observe that India's share in the total imports of raw cotton in Japan, which had stood at nearly 32 per cent in 1934 prior to the Indo-Japanese Trade Agreement, sharply rose to 43 per cent in 1934 and to 44 per cent in 1936, chiefly at the expense of the U.S.A. The exports of raw cotton contributed as much as 23·03 per cent of the total value of all merchandise exports

in 1936-7 as compared with 21·47 per cent in 1935-6. Owing mainly to efforts made by the Lancashire Indian Cotton Committee to promote the increasing use of Indian cotton in Lancashire mills, the exports to the United Kingdom steadily advanced from 342,000 bales in 1933-4 to 601,000 bales in 1936-7. The exports of Indian piece-goods bear only a very small proportion to the total Indian production. In 1936-7 exports were 3 per cent of the total production, as against 2 per cent in the preceding year. The exports to Iran and Iraq have declined in recent years mainly owing to severe competition of the European countries which serve these areas from the North and West and the restrictions existing in Iran on the imports of textile goods. Ceylon is the most important market for Indian piece-goods. The total exports of raw and manufactured jute during the year 1936-7 amounted to 1,792,000 tons as compared with 1,523,000 tons in 1935-6—an increase of 18 per cent. The value of these shipments also rose by 16 per cent from Rs. 37 crores to Rs. 43 crores. Both raw and manufactured jute showed increases. The exports of raw jute at 821,000 tons were the highest since 1928-9 and were valued at Rs. 14,77 lakhs. The exports of jute manufactures in the same year (1936-7) were valued at Rs. 28 crores as compared with Rs. 23 crores in 1935-6.

The next most important article in our export trade is tea. Exports of tea amounted to 302 million lb. valued at Rs. 20,04 lakhs in 1936-7 as compared with 313 million lb. valued at Rs. 19,82 lakhs in 1935-6. In 1936-7, 77 per cent of the total quantity of tea produced was exported overseas. The exports are at present regulated by the international restriction scheme, India's quota for 1936-7 being fixed at 309 million lb. as against an actual export of 302 million lb. during the same year. This scheme has enabled the Indian tea industry to withstand the trade depression better than most other industries. Of the total exports of 302 million lb. in 1936-7, shipments to the United Kingdom accounted for 256 million lb. as compared with 276 million lb. out of the total of 313 million lb. in the preceding year.

Oil-seeds occupied the fourth place among Indian exports in 1936-7. The total exports of oil-seeds showed an increase of 72 per cent in quantity and 79 per cent in value and amounted to 1,155,000 tons valued at Rs. 18,44 lakhs as compared with 673,000 tons valued at Rs. 10,29 lakhs in 1935-6. Despite growing internal consumption, all the principal varieties of oil-seeds, with the exception of castor, recorded increases in exports. While on the one hand, regulation or restriction of imports into European countries, especially Germany and Italy, have adversely affected

the demand for Indian exports, the greater reliance by the United Kingdom on the oil-bearing materials from Empire sources for its requirements of raw materials and the 10 per cent preference in favour of Indian linseed obtaining in the United Kingdom market have had a favourable effect on prices and exports from India. India contributed 75 per cent to the total imports of linseed into the United Kingdom during 1936-7 as compared with 29 per cent in 1935-6 and 58 per cent in 1934-5. The deficiency of the Argentine crop has also helped Indian exports of linseed. Exports of groundnuts during 1936-7 advanced to 739,000 tons valued at Rs. 12,29 lakhs, from 413,000 tons valued at Rs. 6,65 lakhs in 1935-6. The reduction in the import duty in France made that country a more active buyer of groundnuts. The total exports of food grains and flour, which occupied the fifth place among Indian exports in 1936-7, increased from 1,553,000 tons valued at Rs. 12,41 lakhs in 1935-6 to 1,887,000 tons valued at Rs. 15,38 lakhs in 1936-7. With the exception of jowar, bajra and maize, exports of the principal food grains (viz. rice, wheat, pulse, barley, etc.) recorded increases. Rice accounted for 78 per cent of the total quantity of food grains and flour exported during 1936-7. Exports of rice from Burma and India together amounted to 1,446,000 tons, Burma alone being responsible for 84 per cent of the total exports. The imposition of a protective duty of 12 as. per maund on imports of broken rice, chiefly from Siam, effective till the end of March 1938, has served to check imports of foreign rice in India. Exports of Indian wheat amounted to 231,500 tons valued at Rs. 209½ lakhs in 1936-7 as against 9 600 tons valued at Rs. 9½ lakhs in the preceding year. The United Kingdom was the principal buyer, taking 203,400 tons in 1936-7. Imports of foreign wheat into India were insignificant.

The exports of hides and skins in 1936-7 increased by 5 per cent in quantity and by 7 per cent in value, from 48,800 tons valued at Rs. 413 lakhs in 1935-6 to 51,200 tons valued at Rs. 4,43 lakhs in 1936-7. The revival of the trade in tanned hides and skins continued in 1936-7, and the total exports increased from 20,300 tons valued at Rs. 5,20 lakhs in 1935-6 to 25,400 tons valued at Rs. 6,74 lakhs in 1936-7. Exports of metals and ores demand our attention next. The total exports of ores amounted to 748,000 tons in 1936-7, or 45,000 tons less than in the preceding year. Manganese ore represented 91 per cent of the total. As in the preceding year the United Kingdom was the best customer, and as a result of the increased activity in her steel industry she increased her requirements from 197,000 tons in 1935-6 to 216,000 in 1936-7. Exports of pig lead and pig iron showed an improvement. The

trade in raw wool showed a betterment in 1936-7, when exports amounted to 51·9 million lb. valued at Rs. 2,86 lakhs as compared with 49·4 million lb. valued at Rs. 2,10 lakhs in 1935-6. The total exports of lac advanced from 487,000 cwt. in 1935-6 to 834,000 cwt. in 1936-7, and the value increased from Rs. 1,58 lakhs to Rs. 2,34 lakhs. The exports of oil-cakes advanced from 300,000 tons to 336,000 tons in quantity and from Rs. 1,82 lakhs to Rs. 2,27 lakhs in value owing to heavier shipments of all articles coming under the group except linseed cake.

§12. **The direction of India's trade.**—The subjoined tables show the percentage shares of foreign countries in India's total trade:—

TABLE I—Imports (Percentage)

Country	1913-14	1918-19	1922-3	1933-4	1934-5	1935-6	1936-7
United Kingdom ...	64·1	45·5	60·2	41·7	40·6	38·8	38·4
Germany	6·9	...	5·1	7·7	7·6	9·2	9·7
Java	5·8	6·6	5·5	2·1	1·4	1·3	0·3
Japan	2·6	19·8	6·2	14·2	15·7	16·3	17·0
United States of America	2·6	9·5	5·7	6·2	6·4	6·7	6·5
Belgium	2·3	0·8	2·7	2·3	1·6	1·8	2·2
Austria and Hungary ...	2·3	...	0·1	0·5	0·5	0·5	0·4
Straits Settlements ...	1·8	3·3	1·9	2·6	2·3	2·7	3·1
Iran, Arabia, Iraq, Asiatic Turkey and Sumatra	1·5	...	...	1·9	2·5	2·5	2·9
France	1·5	1·1	0·8	1·3	1·2	1·0	0·9
Mauritius	1·3	1·5	0·4	...	...	...	...
Italy	1·2	0·5	0·9	2·5	2·3	1·5	1·0
China	0·9	1·4	1·2	1·9	1·6	1·4	1·1
Netherlands	0·8	0·1	0·9	1·6	1·0	1·0	1·1
Australia	0·5	1·3	0·4	0·9	0·7	0·9	0·9
Hongkong	0·5	1·0	0·6	0·4	0·3	0·3	0·4
Dutch Borneo ...	0·4	...	...	0·3	0·2	0·2	0·2
Ceylon	0·4	1·7	0·6	1·1	1·0	1·1	1·4
Switzerland	0·3	...	...	0·8	1·0	1·1	1·1
Kenya and Zanzibar ...	0·3	...	...	2·1	2·4	2·6	2·8

TABLE II—Exports (Percentage)

Country	1913-14	1918-19	1922-3	1933-4	1934-5	1935-6	1936-7
United Kingdom ...	23·4	29·2	22·0	32·2	31·6	31·5	32·2
Germany	10·6	...	7·5	6·5	4·5	5·9	4·7
Japan	9·1	12·1	13·4	8·5	16·1	13·4	15·0
United States of America	8·7	13·8	11·5	9·6	8·3	10·1	9·5
France	7·1	3·6	5·1	4·9	3·2	4·4	3·9
Belgium	4·8	0·004	3·8	3·0	2·6	3·4	3·6
Austria and Hungary ...	4·0	0·06	0·4	...	...	...	...
Ceylon	3·6	4·2	4·1	4·2	4·5	4·5	3·8
Iran, Arabia, Iraq, Asiatic Turkey and Sumatra	3·2	4·0	3·4	1·8	1·9	1·7	1·9
Italy	3·1	2·2	2·2	3·8	3·8	2·2	2·4
Hongkong	3·1	2·9	2·5	0·8	0·6	0·3	0·3
Straits Settlements ...	2·7	1·1	4·6	2·3	1·9	2·3	2·2
China	2·3	0·03	...	3·0	1·9	1·1	0·6
Central & South America	2·2	...	...	2·2	2·6	2·0	2·3
Netherlands	1·7	2·6	1·3	2·7	1·9	2·3	2·2
Australia	1·6	...	1·8	2·0	1·9	1·8	1·6
Kenya and Zanzibar ...	1·0	...	...	0 5	0·6	0·4	0·4
Union of Socialist Soviet Republics	0·9	...	0·003	0·1	...	0·2	0·2
Spain	0·8	...	...	0·9	0·6	1·1	0·3
Java	0·8	1·4	1·0	0·3	...	0·3	0·4

These figures show that, on the import side, the United Kingdom, and Europe generally, dominate the situation, while a feature of the distribution of the export trade has always been the large number of countries participating in it, though the United Kingdom is still the biggest single customer for Indian exports. The causes of the predominance of the United Kingdom in India's trade have already been indicated, as also the successful attempts made by Germany and Japan to establish direct trade relations with India in the pre-War period, and by the United States during and since the War. We may now discuss the principal tendencies regarding the direction of India's trade as revealed by the above figures, during, before and after the War.

§13. **Pre-War distribution of India's trade.**—During the pre-War period there was a tendency for both the import and export trade to be diverted from the United Kingdom to other countries. As regards the distribution of imports, the United Kingdom supplied at the close of the last century as much as 69 per cent of the Indian imports. The share of Germany was only 2·4 per cent and that of the United States 1·7 per cent, Japan being nowhere with her 0·6 per cent. By 1913-14 we notice that a remarkable change has taken place. While the share of the United Kingdom has come down to 64·1 per cent, the German share has increased to 6·9 per

cent and those of Japan and the United States to 2·6 per cent each. Thus Germany occupied the second place next to the United Kingdom in 1913-14. The increase in the trade with Germany was attributed partly to the special technical skill which she had developed in certain lines, partly to the displacement of the expensive British goods by cheaper substitutes more readily absorbed by the Indian bazaars, and partly to the careful study which the Germans devoted to the needs and tastes of Indian customers. The share of Belgium, which supplied 3·9 per cent of the imports in 1903-4, was reduced to 2·3 per cent, while Java on account of her increased exports of sugar to India shot ahead and occupied the third place, contributing 5·8 per cent of the total imports in 1913-14.

The export trade showed a similar tendency towards diversion from the United Kingdom in the pre-War period. At the beginning of the present century, roughly speaking 29 per cent of the exports went to the United Kingdom, 25 per cent to continental Europe, 24 per cent to the Far East and 7 per cent to the United States and the remaining 15 per cent to other countries. By 1914, the United Kingdom's share was reduced to 24 per cent, that of continental Europe rose to 29 per cent, the Far East took only 17 per cent, owing to the fall in the exports of opium and yarn, the share of the United States rose to 9 per cent, and that of other countries to 21 per cent. It will thus be seen that during this period continental Europe gained what the United Kingdom lost. The loss in the eastern market was made good by the gain in those of other minor countries. Turning to individual countries we find that, apart from the United Kingdom which was the biggest individual buyer of Indian goods, Germany which was third in the list in 1900 rose to the second place in 1914, the value of exports to Germany rising from £5·0 millions in 1900 to £17·5 millions in 1914. Japan showed a similar improvement in her buying capacity, her imports rising from £4·2 in 1900 to £15·1 millions in 1914. She thus advanced from the sixth place to the third as a buyer of Indian goods. China, on the other hand, lost the second place which she had occupied in 1900 and ranked sixth in 1914.[1]

During the War period, while the pre-War tendency of the import trade to move away from the United Kingdom gained in streng[illegible]he United Kingdom lost further ground in the Indian mark[illegible] to her pre-occupation with the War, the control of the [illegible]vernment on her exports and the restrictive effects of high prices. And her share in the import trade came down from 64·1 per cent in 1913-14 to 45·5 per cent in 1918-19. This, coupled

[1] See R. M. Joshi, *Indian Export Trade*, pp. 159-60.

with Germany's exit from the Indian market, created a gap in the import trade, a portion of which was rapidly filled up by Japan and the United States. Iron and steel and hardware previously supplied by the United Kingdom had now to be imported from these countries; while glassware, cotton piece-goods, paper, etc., had to be imported from Japan, and dye-stuffs from the United States. Both these countries made special efforts to study the requirements of the Indian market as Germany had done in the pre-War period, and extended their commercial organization in the country, which in the case of Japan included the establishment of retail stores in the principal Indian towns. The Japanese exchange banks in India also extended special financial facilities to the importers.[1]

On the export side, the tendency was for a temporary reversion of the trade to the United Kingdom and the British Empire as a result of the War-time purchases and special measures taken to facilitate them, including restrictions on trade with neutral countries and the grant of credit facilities to some of the Dominions. All this was reflected in an increase in the share of the United Kingdom in the export trade from 23·4 per cent in 1913-14 to 29·2 per cent in 1918-19, while the share of the British Empire as a whole increased from the pre-War average of 41·1 per cent to 51·7 per cent (War average). Germany of course disappeared altogether as a buyer from the Indian market. The shares of France and Belgium were also reduced on account of the occupation of their territories by Germany. Japan and the United States, on the other hand, increased their share from 9·2 per cent and 8·9 per cent in 1913-14 to 12·1 and 13·8 per cent respectively in 1918-19. This increase was due to several factors, such as the privileged position held by these two countries as allies who, moreover, were removed far away from the theatres of war; their increased export trade with India establishing credits for them; and the conscious efforts made by both to develop direct trading relations with India. There was also a general reduction in the demand for Indian produce for

[1] 'The most remarkable feature of the Japanese organization for the development of foreign trade was the way in which all the branches of her commercial activity, the mercantile houses, the banks and the shipping companies, assisted by the Japanese Government, combined closely for the furtherance of the national interest, and by means of the preferential treatment of their own people as against foreign competitors, managed to secure business for each other and to keep it out of the hands of their foreign rivals. This cohesion of all the interests for the furtherance of the national welfare was carried to an extent which was not achieved by any other nation, not even by commercial Germany before the War.'—Panandikar, *The Economic Consequences of the War for India*, p. 84.

normal industrial activity elsewhere. Thus, on the whole, during the War period India had to sell her produce in a restricted market, and, though she received higher prices for it than before the War, the prices she had to pay for her imports were far higher.

§14. **Post-War tendencies of India's foreign trade.**[1]—After a temporary and partial recovery on the import side in the early post-War period, the United Kingdom again experienced a setback, and the progressive decrease in its share in the import trade was accentuated in 1926-7 by the prolonged coal strike which seriously affected its industries, its share decreasing to 47·8 per cent of the total import trade in that year. In the year 1927-8 its position remained very much the same as in the preceding year. The year 1928-9, however, recorded a striking decrease, namely, to 44·7 per cent as compared with the pre-War 64·1 per cent.[2] There was a further decline to 42·8 per cent in 1929-30, 37·2 per cent in 1930-1 and 35·5 per cent in 1931-2, the decrease in the last two years being accentuated by the political situation in India. The United Kingdom has had again to experience the competition of foreign countries such as Germany, Japan, and the United States in the Indian market. We have already referred to the Japanese competition in cotton piece-goods in the Indian market not only with mills in India but also to some extent with Lancashire. Another explanation of the setback to the import trade of Great Britain with India may be found in the fact that until 1936-7 Great Britain bought much less from, than she sold to, India, whereas Japan, Germany and the United States usually bought more heavily from India and thus were enabled to sell much. Between 1932-3 and 1933-4 there was an improvement in the position of Great Britain, her share having risen to 41·7 per cent in 1933-4. This recovery may be largely attributed to the favourable position Great Britain enjoys in the Indian market under the Ottawa preferences introduced with effect from 1 January 1933. The percentage share of the United Kingdom has been steadily on the decline in recent years being 38·4 in 1936-7. Japan and the United States have naturally lost part of the ground captured by them during the War, Japan receiving a special setback owing to the commercial crisis of 1920-1. Another cause which has affected the imports from both countries may be traced to the reappearance of old rivals and the restoration of more normal conditions of competition in the Indian markets. Japan increased her share from 14·2 in 1933-4 to 17 per cent in 1936-7, while the participation of the U.S.A. declined from 6·7

[1] See also Vera Anstey, *Trade of the Indian Ocean*, pp. 74-9.

[2] Similarly, the share of the whole British Empire dropped from 51·5 per cent in 1929-30 to 46·1 per cent in 1930-1.

per cent in 1935-6 to 6·5 per cent in 1936-7. Germany advanced her share in imports from 9·2 per cent in 1935-6 to 9·7 per cent in 1936-7. Her share, which in the pre-War year 1913-14 was 6·9 per cent, had declined to 5·1 in 1922-3. She has thus shown a remarkable recovery in recent years so far as India's import trade is concerned. Belgium accounted for 2·2 per cent and France for less than 1 per cent in 1936-7.

On the export side there was a definite tendency towards diversion, as was to be expected after the War, away from the United Kingdom, which diminished its share to 21·4 per cent in 1926-7 as compared with the pre-War figure of 23·4 per cent. After a temporary increase (25·0 per cent) in 1927-8, there was again a decline to 21·4 per cent in 1928-9. There was a rise from 21·8 per cent in 1929-30 to 24 per cent in 1930-1, 27·9 per cent in 1931-2 and 32·2 per cent in 1933-4. After having declined to 31·5 in 1935-6, it again rose to 32·2 in 1936-7. This shows that the share of the United Kingdom in the export trade has considerably improved in recent years. Indeed, the usual excess of imports over exports in the case of the United Kingdom was transformed in the year 1936-7 into a favourable balance of Rs. 18 crores. Japan showed a striking improvement in her relative position in the export trade, her percentage share advancing by 7·2 to 15·7 per cent in 1934-5 due to the large shipments to that country of raw cotton, metals and ores, gunny bags and shellac. After having declined to 13·4 per cent in 1935-6 it again rose to 15 per cent in 1936-7. The share of the U.S.A. in exports, which had shown some improvement in 1935-6, again receded and was 9·5 per cent in 1936-7 as compared with 10·1 per cent in the preceding year. Germany had a smaller proportion of the export trade, namely, 4·7 per cent, in 1936-7 as compared with 5·9 per cent in 1935-6, and 9·9 per cent in 1927-8. Belgium contributed 3·6 per cent to India's export trade in 1936-7, the percentage share of France being 3·9 per cent.

To sum up the general trend of the post-War developments of India's foreign trade, the pre-War tendency of a diversion of both the export and the import trade from the United Kingdom reasserted itself more forcibly than ever, especially on the side of imports, until 1931-2. After that, we have pointed out that there was recovery in its share especially in the export trade of India. The recovery has been partially lost in the case of import trade in recent years. Japan and the United States are the most formidable competitors of England in the Indian market. Germany has almost regained her former position in respect of imports, although her participation in our export trade has been smaller

in recent years. All these nations command an excellent commercial organization for pushing their trade with India; and in this respect they have stolen a march upon the United Kingdom, which is now, however, awakening to the necessity of following in their footsteps. The Ottawa preferences, introduced at the beginning of the year 1933, are also to some extent helping her to recover her position in India's foreign trade although the growing industrialization of the country under the ægis of protection must necessarily make recovery in this respect difficult, if not impossible.

Tables III and IV below indicate the direction and variations of India's trade in some of the more important commodities on the import and export side respectively. The main features regarding the direction of India's trade, most of which are clearly revealed by these tables, may be thus summed up:—

(i) *Imports.*—It will be observed from table III that the United Kingdom is threatened with competition in almost every line, including those which have hitherto been regarded as preponderatingly British. Though the United Kingdom is still the principal supplier of cotton manufactures to India, her share steadily decreased from 71·3 per cent in 1928-9 to 50·7 per cent in 1936-7, as against 90·1 per cent in 1913-14; and that of Japan increased from 18·3 per cent in 1928-9, to 43·2 per cent during the same period as against 1·8 per cent in 1913-14, the increases being mainly in cotton twist and yarn and gray and coloured goods. Java continued to be the principal source of imports of sugar, though the total imports are no longer considerable. A feature of the trade in 1936-7 was the large increase in the share recorded under China (including Hong-Kong), whence large quantities of sugar, apparently of foreign origin, are consigned to India. The United Kingdom has lost ground during post-War years in the supply of iron and steel, machinery and hardware to the United States, Germany, Belgium and even Japan, though she is the largest single supplier, especially of iron and steel, and machinery. In iron and steel the United Kingdom maintained a predominant position and accounted for over 56 per cent of the total trade in 1936-7, almost the same as in the preceding year. The decline in the share of Germany, France and Luxemburg was accompanied by an increase in Belgian participation. In recent years Japan has steadily increased her contribution from 6 per cent in 1935-6 to 8 per cent in 1936-7. In machinery the increase in the share of Japan since 1934-5 was at the expense of the United Kingdom, which is by far the largest supplier. Among other countries, the U.S.A., Germany, Belgium, and Sweden improved their contributions as compared with the preceding year. In the case of hardware the United Kingdom

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TABLE III—Direction of India's trade [1]

IMPORTS (Percentage) Dots (...) indicate that the trade is either *nil* or insignificant

Country	Cotton manufactures		Sugar		Iron and Steel		Machinery		Hardware		Motor cars, etc		Mineral oils		Paper and pasteboard	
	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7
United Kingdom	90·1	50·7	1·8	4·8	69·9	56·3	89·8	65·5	57·2	34·1	71·3	41·9	5·7	5·3	56·0	30·5
United States	0·4	0·1	...	...	2·6	1·5	3·3	8·9	9·7	8·9	15·1	38·0	56·1	15·7	...	1·1
Germany	2·1	0·3	...	...	14·5	12·0	5·6	14·3	18·2	32·4	...	6·0	7·3	3·4	17·0	25·2
Belgium	...	0·1	...	0·3	11·5	14·1	...	2·2	...	1·0	4·5	...	...	...	...	...
Japan	1·8	43·2	...	3·2	...	7·9	...	1·3	1·5	11·8	...	0·7	...	...	...	...
France	...	0·3	...	...	...	2·3[2]	...	0·3[2]	...	0·6	4·5	0·3	...	...	...	0·4
Italy	1·5	0·2	...	...	...	...	...	...	...	...	...	1·1	...	...	...	...
Netherlands	1·6	0·5	...	7·4	...	...	...	...	...	...	...	...	...	...	2·5	3·9
Australia	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Norway	...	...	...	...	...	...	...	...	...	...	...	...	...	...	5·0	10·8
Sweden	...	...	...	...	...	1·9	...	1·3	0·9	5·3	...	...	...	...	3·1	11·5
Canada	...	...	...	...	...	...	...	...	...	...	...	11·2	...	...	...	...
Borneo, Sumatra, etc.[2] ...	...	...	...	...	...	...	...	...	...	...	...	...	25·1	19·2	...	0·1
Java and Straits Settlements ...	...	...	71·8	55·7	...	...	...	...	...	...	...	...	...	...	...	...
Mauritius	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Iran	...	...	...	...	...	...	...	...	...	...	...	...	3·7	34·5	...	...
U.S.S.R.	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
China	0·1	2·1	...	27·2	...	...	...	...	...	...	...	...	0·9	20·4	...	...
Switzerland	...	1·7	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Austria	...	...	...	...	...	...	...	...	...	...	...	...	...	...	8·3	3·1
Percentage of total trade represented by countries shown ...	97·6	99·3	90·5	98·6	98·5	96·0	98·7	93·8	87·5	94·1	95·4	99·2	98·8	98·5	91·9	86·6
Value of trade (crores of rupees)	66·3	17·5	14·9	0·24	16·0	5·9	7·8	14·1	3·8	2·9	1·5	1·5	4·1	5·9	1·6	2·8

[1] *Review of the Trade of India* (1936-7).   [2] Includes the Straits Settlements and other islands.

TABLE IV—Direction of India's trade [1]

EXPORTS (Percentage) Dots (...) indicate that the trade is either *nil* or insignificant

Country	Tea		Jute (raw)		Jute manufactures		Cotton (raw)		Hides and Skins (raw and tanned)		Oilseeds		Food grains	
	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7	1913-4	1936-7
United Kingdom	72·4	85·6	38·0	23·6	6·3	9·7	3·5	14·2	25·9	67·1	22·2	28·0	26·7	16·2
Canada	4·3	3·7	...	0·1	...	3·3	...	...	...	...	...	...	...	...
Australia	3·1	0·2	...	0·2	10·6	8·5	...	...	...	...	...	...	...	...
United States	0·7	2·1	11·9	10·8	41·5	31·9	...	2·0	24·3	15·3	1·2	1·8	...	0·2
Germany	...	...	21·8	15·9	...	0·2	14·6	5·1	20·3	5·0	16·0	8·7	7·8	3·1
Japan	...	...	...	3·9	0·5	2·4	47·2	57·2	...	2·4	...	0·3	3·8	4·0
France	...	...	9·9	10·7	...	0·1	...	3·6	...	2·4	31·4	16·5	...	1·0
Italy	...	...	5·5	9·5	...	...	7·7	3·8	5·3	1·1	5·0	6·8	...	0·6
Belgium	...	...	0·5	8·4	...	0·8	10·3	7·3	...	0·2	16·0	2·9	...	0·5
Ceylon	1·6	0·9	...	...	...	0·1	...	0·1	...	...	...	0·6	11·5	24·8
U.S.S.R.	11·1	0·6	...	...	...	...	...	...	...	...	...	...	...	...
Iran, Arabia, etc.	1·2	5·0	...	2·0	...	0·8	...	...	...	0·3	...	0·3	5·6	4·0
Java	...	...	...	...	2·5	2·5	...	...	...	...	...	...	...	...
Argentine Republic	...	...	...	0·9	10·4	10·4	...	...	...	...	...	...	...	...
China	...	...	...	...	...	...	1·7	1·6	...	...	...	...	...	1·4
Spain	...	...	2·8	2·0	...	...	...	0·6	2·8	...	...	0·3	...	...
Netherlands	...	...	...	...	...	...	...	1·1	3·3	1·0	1·0	7·3	6·8	2·2
Straits Settlements	...	...	...	...	...	...	...	...	...	0·1	...	0·3	6·7	8·8
Sumatra and Java	...	...	...	...	...	...	...	...	...	...	...	...	1·0	2·1
Egypt	0·5	0·1	...	0·8	2·1	2·6	...	...	...	...	...	...	...	...
Union of South Africa	...	0·1	...	...	1·7	2·9	...	...	...	...	...	...	...	...
Siam	...	...	...	...	1·6	1·8	...	...	...	...	...	...	...	...
Percentage of total trade represented by countries shown ...	94·9	98·3	90·4	88·8	77·2	78·0	85·0	96·6	81·9	94·9	92·8	73·8	69·6	68·9
Total value of trade (crores of rupees)	15·0	20·0	30·8	14·8	28·2	28·0	41·0	44·4	15·9	11·0	25·6	18·4	45·1	15·4

[1] *Review of the Trade of India* (1936-7), pp. 133-4.

gained ground in 1936-7, her share having risen to 34·1 per cent from 31·8 per cent in 1935-6. Japan also increased her participation from 10·9 per cent to 11·8 per cent. On the other hand, the shares of Germany, the U.S.A. and Sweden declined.

Under mineral oils, Iran, the U.S.S.R. and the United States of America lost ground, while Borneo and Sumatra considerably improved their position. In motor vehicles the share of the United Kingdom rose from 41·7 per cent in 1935-6 to 41·9 per cent in 1936-7, and that of the U.S.A. from 35·5 per cent to 38·0 per cent during the same years. Germany also advanced her share to 6 per cent, while the share of Canada dropped from 17 per cent in 1935-6 to 11·2 per cent in 1936-7.

(ii) *Exports.*—On the export side, the United Kingdom is by far the largest single customer for Indian tea, taking 85·6 per cent of the total exports in 1936-7 as compared with 89·6 per cent in 1935-6; Canada's share improved from 3·2 per cent in 1935-6 to 3·7 per cent in 1936-7. The share of the U.S.A. improved from 1·9 per cent in 1935-6 to 2·1 per cent in 1936-7. Direct trade in tea with the U.S.S.R is now insignificant, though Russia absorbed 11 per cent of the total exports of tea in the pre-War year. In raw jute, the United Kingdom absorbed 23·6 per cent in 1936-7 as compared with 21·6 per cent in the preceding year. Among other European countries, Germany and Spain considerably reduced their participation, while the shares of France, Belgium and Italy increased. The shares of the United States of America and Japan showed increases. In the case of jute manufactures, America as usual was the principal outlet, but her relative share fell from 32·1 to 31·9 per cent, while those of the United Kingdom and Argentina increased from 8·8 per cent to 9·7 per cent and 10·4 per cent respectively. The share of Australia declined from 9·3 to 8·5. Siam, Canada, the Union of South Africa and Japan are other customers for Indian jute manufactures. In raw cotton Japan is the heaviest buyer and accounted for 57·2 per cent of the total value of the exports in 1936-7 as against 53·1 per cent in 1935-6. The relative share of the United Kingdom increased from 13·4 per cent in 1935-6 to 14·2 per cent in 1936-7. While Belgium increased her share from 6·5 per cent to 7·3 per cent, the shares of Germany, France and Italy declined. In food grains, Ceylon is the best customer for Indian rice, and accounted for 24·8 per cent of the total value of food grains exported in 1936-7 as compared with 31·1 in 1935-6. The United Kingdom, Straits Settlements, China, Sumatra and Java, Germany and Belgium are other large customers for Indian food grains. The share of the United Kingdom advanced from

5·2 per cent in 1935-6 to 16·2 per cent in 1936-7, due to larger shipments of wheat. In oilseeds, France takes more groundnut from India than any other country. The United Kingdom, Germany, Italy, and the Netherlands are other principal countries who import oilseeds from India. There was a considerable improvement in the share of the United Kingdom, which rose from 25 in 1935-6 to 28 per cent in 1936-7. The share of Italy improved from 4·7 per cent to 6·8 per cent and that of Belgium from 2·2 per cent to 2·9 per cent. On the other hand, the shares of France and Germany showed decreases. In hides and skins the United Kingdom and the United States are the largest buyers. The share of the United Kingdom rose from 61·7 per cent in 1935-6 to 67·1 per cent in 1936-7, and of France from 1·5 per cent to 2·4 per cent. There was a very marked decrease in the share of the United States of America, which fell from 19·7 per cent to 15·3 per cent. Germany has reduced her share in the takings of raw hides as compared to her pre-War requirements, when she was one of the best purchasers of Indian hides. Italy also now imports much less than she used to.

§15. **Entrepot (re-exports) trade of India.**—The entrepôt trade of a country consists of the re-exports of articles previously imported, the country in question serving merely as a convenient distributing centre. From very early times India has had a certain amount of entrepôt trade, principally by reason of her geographical situation. Being situated in the centre of the Eastern hemisphere she is a convenient halting place for the trade between the Far East and the West. Thus in the old times, ' this section of trade consisted chiefly of the import of silk goods and porcelain from China, pearls from Ceylon, precious stones and spices from the islands of the Eastern Archipelago—all for purposes of re-export to countries of the west; Venetian glass and the like from countries of the west to be re-exported to the east '.[1] In more recent times India's entrepôt trade was seen steadily to expand till a short while ago, showing an increase from Rs. 5·80 crores in 1882-3 to Rs. 18·04 crores in 1920-1. Since the latter year, however, it has fallen, and amounted to Rs. 13½ crores in 1924-5, Rs. 10½ crores in 1925-6, Rs. 8 crores in 1926-7, Rs. 9½ crores in 1927-8, Rs. 7·83 crores in 1928-9, Rs. 7 crores in 1929-30, Rs. 5 crores in 1930-1, Rs. 4·65 crores in 1931-2, Rs. 3·22 crores in 1932-3. In 1933-4 the re-export trade in foreign merchandise improved slightly from Rs. 3·22 crores to Rs. 3·42 crores. The years 1934-5 and 1935-6 saw a further expansion, the value of re-exports having risen to Rs. 3·55 crores

[1] K. T. Shah, *Trade, Tariffs and Transport in India*, p. 92.

and Rs. 3·76 crores respectively. It showed a noticeable increase in the year 1936-7 when it amounted to Rs. 6·24 crores. The percentage shares of the principal countries in the re-export trade of India in the year 1936-7 were as follows:—United Kingdom 49 per cent; United States 11 per cent; Ceylon, Aden and Dependencies 5 per cent each; Japan and Iraq 4 per cent each; Arabia, Iran and Kenya Colony 3 per cent each; and Germany, the Straits Settlements, the Anglo-Egyptian Sudan and Bahrein Islands 2 per cent each. As usual the bulk of the re-export trade passed through Bombay, which accounted for 78 per cent; Karachi came next with 12 per cent, while Bengal had 8 per cent.

The following table[1] shows the value of the principal articles of foreign merchandise re-exported from India, arranged in the order of their importance, in 1936-7 as compared with the average of five pre-War years.

In thousands of rupees

Articles	Pre-War average[2]	1936-7	Articles	Pre-War average	1936-7
Hides and skins (raw) ...	...	251,65	Hardware ...	13,89	15,67
Wool, raw ...	42,50	38,29	Sugar	52,95	14,59
,, manufactures ...	4,16	14,65	Fruits and vegetables ..	13,11	13,60
Total ...	46,66	52.94	Machinery and millwork . .	5,68	12,95
Metals and ores ...	20,05	41,41	Apparel	15,89	5,93
Cotton, raw ...	14	1,64	Gums and resins ..	10,54	5,15
,, manufactures ...	157,51	27,50	Haberdashery and millinery ..	...	4,55
Total ...	157,65	29,14	Rubber manufactures ...	1,12	2,79
Vehicles	7,52	27,15	Postal articles ...	16,24	1,79
Silk, raw ...	1,23	29	All other articles ...	92,12	1,19,48
,, manufactures etc.	7,03	24,99			
Total ...	8,26	25,28	Total value of re-exports ...	4,61,88	6,24,07

It will be seen from the above table that the re-export trade is mainly in manufactured articles imported from Western countries, especially cotton textiles which are taken by Iran, Muscat, and East Africa. The principal article re-exported to Western countries

[1] *Review of the Trade of India* (1936-7), pp. 197-8.

[2] The War average was Rs. 8,14,38 thousands while the post-War average was Rs. 15,64,74 thousands.

is raw wool which is imported across the land frontiers of India, the bulk of which goes to the United Kingdom. A certain amount of fur skins from Iran are exported from Bombay, which also re-exports pearls previously imported from the Bahrein Islands, Muscat, etc.

Though India will always act as a distributing centre to a certain extent, particularly for those Asiatic countries which have no seaboard of their own and to which the Indian ports afford the nearest approach for maintaining trade relations with other countries, the prospects of the entrepôt trade of India are not bright in view of the growing tendency towards the establishment of direct trade relations among the various countries, lessening their dependence on India as an entrepôt.

§16. **Balance of trade and balance of payments (accounts).**—A large surplus of exports over imports of private merchandise used to be a normal and much noticed feature of India's foreign trade. Occasionally India has experienced what is called an adverse balance of trade, that is to say, there has been an excess of imports of merchandise over exports, for example in the years 1920-1 and 1921-2 (see §6 above). The normal excess of exports over imports (the so-called favourable balance of trade) was liquidated partly by importation of precious metals—gold and silver—and partly by payment of interest and other Home charges, which may be described as India's invisible imports (see §17 below). India's average credit balance in merchandise was Rs. 78 crores in the five pre-War years, Rs. 76 crores during the five War years and Rs. 53 crores during the five post-War years ending 1923-4. During the next quinquennium ending 1928-9 the average rose to Rs. 1,13 crores, but it dropped to a low figure of Rs. 43 crores during the five years ending 1933-4. The year 1932-3 was the least favourable, the credit balance dropping to a little over Rs. 3 crores. In 1933-4 the balance in favour of India rose to Rs. 35 crores. But the following year (1934-5) saw a deterioration of the position, the balance dropping to Rs. $23\frac{1}{2}$ crores. In 1935-6 it rose to Rs. $30\frac{1}{2}$ crores and in the following year (1936-7) was more than doubled, being Rs. $77\frac{3}{4}$ crores. This large favourable balance was the result of an increase of Rs. 38 crores in exports and a decrease of Rs. 9 crores in imports. The trade depression since 1929, the restrictions on the free movement of goods and the changes in the volume and character of international trade have had an adverse influence on India's balance of trade, especially during the critical years of the depression period. While in itself a low credit balance need not cause perturbation, the matter is of significance in the case of India, which has large overseas obligations to meet. The

alleviating circumstance in this connexion has been the exports of gold from India which first came into evidence in 1931.[1] The change in India's position from a gold-importing country to a gold-exporting country has been one of the most important factors affecting her international trade account. This is clearly brought out by the table on page 269. The normal absorption of the precious metals was first checked in 1931-2, when there was a net export of gold to the value of Rs. 58 crores. In 1932-3 and 1933-4 there were net exports to the value of Rs. 65½ and Rs. 57 crores respectively. In 1934-5 the net exports amounted in value to Rs. 52½ crores. In 1935-6 the exports of gold declined to Rs. 37⅛ crores and in 1936-7 to Rs. 28 crores.[2] It will be seen that with an increase in the favourable balance of trade in merchandise there was a contraction in the export of gold. In the year 1936-7 the net imports of silver, which had risen from Rs. 37 lakhs in 1934-5 to Rs. 1,27 lakhs in 1935-6 advanced to Rs. 13,59 lakhs. The visible balance of trade, as measured by statistics of private merchandise and treasure, was in favour of India to the extent of Rs.92 crores in 1936-7, as compared with Rs. 67 crores in 1935-6 and Rs. 76 crores in 1934-5. The total value of gold exported from India since England went off the gold standard on 20 September 1931, amounted to Rs. 315·2 crores at the end of the week ending 25 June 1938.

In a proper balance of accounts or payments there must be an exact equivalence between exports and imports, and this will be seen to be established, if we could take into account not only the visible items, that is to say those items which are recorded in the customs returns or in other published statistics, but also the invisible items, that is to say those items which are not thus recorded.

§17. **Credit and debit items in India's balance sheet.**—We shall now consider what items have to be taken into account for a complete international balance sheet and how India stands with regard to each of them :[3]

(i) Imports and exports of merchandise. Under this head, as we have already seen, India is a creditor country. (ii) With regard to treasure, however, India until recently (1930-1) used to import more than she exported and therefore she was a debtor on this account. Since 1931-2, as pointed out above, the situation

[1] This unusual phenomenon of the large exports of gold in recent years is examined in chapter viii.

[2] In the year ended 31 March 1938 the favourable balance of trade as well as the net export of gold showed a considerable decline.

[3] See Morison, *The Economic Transition in India*, ch. viii.

has been reversed and she has been exporting large amounts of gold which make her a creditor on this account. (iii) Loans offered or received from abroad. While a loan is being carried out, the nation which contracts the debt is the creditor and the nation which advances the loan is the debtor. Under this head India is a creditor country as she has had to raise large loans in England from time to time. (iv) The annual interest on capital already invested has the opposite effect, making the borrowing country a debtor and the lending country the creditor, and as India has to make annual remittances of interest on the loans she has contracted she is a debtor under this head. (v) The repayment of the loan itself also makes the borrowing country the debtor and the lending country the creditor. And as India is constantly paying off portions of her foreign debt in addition to paying the interest year after year, she is under this head a debtor country. The repayment of the loan may take the form of Indians' purchasing the rupee paper held in England and thus bringing the debt home. But the effect of this is the same as if the Government had paid the debt out of its revenues, namely, that India's foreign obligations are lessened so far. (vi) The earnings of Indians living abroad and of foreigners residing in India, so far as they are remitted in each case to their native country by the parties concerned. In the former case India is a creditor and in the latter she is a debtor. But on the whole, under this head India is a debtor. The remittances abroad of European merchants and business men, bankers and Government officials far outweigh the remittances to this country of Indian merchants and coolies residing outside India. (vii) The profits of foreign banks and shipping and insurance companies. India's payments under the head of banking profits, shipping freights and premiums of insurance, are not precisely calculated but must aggregate to a very large sum representing India's indebtedness to that extent. (viii) The remittances of money by foreigners for benevolent purpose to a country or donations sent abroad by the country make it a creditor in the former case and a debtor in the latter. Under this head India is a creditor country, because she receives more money from Europe and America for the support of missions and missionary schools in India as well as in the form of occasional subscriptions raised abroad for the relief of famines in India and other calamities, than she sends to foreign countries for similiar purposes. (ix) The expenditure of a nation's Government abroad will make it a debtor to that extent, and, conversely, the expenditure of other Governments in a country will make it so far a creditor. On this account India is a

debtor as she has to spend large amounts of money in England by way of furlough pay and pensions of European officers who have served in India, and for the purchase of stores, etc. She has also to pay the English Government for various kinds of expenditure incurred by the latter for India. All this expenditure on Government account in England is included under the Home Charges. (x) The payment of tributes or indemnities obviously makes the paying country debtor and the receiving country creditor. As India neither pays nor receives a tribute or indemnity, this heading has to be altogether ignored. (xi) The expenditure of foreign tourists in India and Indian tourists abroad.

Credit	*Debit*
1. Exports of merchandise.	1. Imports of treasure.[1]
2. Loans raised abroad.	2. Interest on loans raised abroad
3. Remittances by foreigners to India for the support of schools and missions and for the relief of famines and other charitable purposes.	3. Repayments of loans previously incurred
4. Tourists' expenses.	4. Remittances abroad by European merchants, lawyers, Government officers, etc.
	5. Profits of foreign banks and insurance companies and freight charges paid to foreign shipping companies.
	6. Expenditure on Government account abroad in connexion with furlough pay, pensions, stores, bullion, etc., purchased for the Government of India (Home Charges).
	7. Remittances to Indian students abroad.

Under this head India is a creditor because the number of foreigners visiting India for sight-seeing is far greater than the number of Indians visiting foreign countries. (xii) On the other hand, India is a debtor to the extent of the remittances for the education of Indian students abroad. The amount thus spent is somewhere in the neighbourhood of a crore of rupees every year, and there is every prospect of its increasing in the future.

[1] Since 1931-2, as already explained, India has become a creditor country with regard to transactions in treasure, and the item 'Exports of treasure' should be included on the credit side of her account.

For a complete balance sheet, therefore, we should have to reckon in all these items, and if that could be done the two sides of the account must balance each other.

In the statement on p. 266, on the right-hand side we have India's debit items, that is, those on account of which India has to pay more money abroad than she receives: and on the left-hand side we have the credit items, that is, those on account of which more money is owing to India from foreign countries than she owes to foreign countries.

§18. **India's visible balance of payments (accounts).**—The statement on p. 269,[1] although it excludes Government stores and Government treasure, goes a few steps further than the balance of trade in merchandise and treasure towards the construction of a complete balance of payments (accounts), by including the transfer of funds from and to India through the Government.

The statement shows in detail the items entering into India's visible balance of payments. The detailed figures work up to a plus or minus balance (the sign + representing net export and the sign – representing net import) for each of the three main heads of classification, namely, (i) private imports and exports of merchandise, (ii) private imports and exports of treasure, and (iii) remittances through the Government—all leading up to a plus or minus total.

The visible balance of accounts finally left here must be taken to represent the net effect of the invisible items that enter into India's balance of accounts, such as shipping services, private remittances, exports and imports of capital, insurances, tourists' expenditure, etc. These have not been included in the statement as the figures cannot be estimated accurately. It will be seen from the table that gold exports in recent years have largely taken the place of the excess of exports of merchandise over imports and have thus helped to maintain the favourable visible balance of trade which is essential to enable India to meet her obligations abroad (i.e. her invisible imports).[2]

[1] Taken from the *Review of the Trade of India in 1936-7*, p. 170.

[2] For further particulars regarding the balance of payments for India the reader is referred to the publication *Balance of Payments* (*1936*) of the Economic Intelligence Service of the League of Nations. An attempt is made here by the Government of India to go beyond the figures relating to the Balance of Trade and Movement of Treasure published in the annual *Review of the Trade of India*. The Balance of Payments is shown separately for (*a*) goods, services and gold (current items) and (*b*) capital items. Under the former head are included the following: 1. Merchandise. 2. Interest and Dividends on long-term and short-term capital. 3. Other services, such as port fees; commissions, insurance, brokerage; post, telegraph and telephone; tourists, diplomatic

§19. **The 'drain' defined.**—India's habitual excess of exports over imports has given rise to the 'drain' theory, which, whatever its other vagaries, has at least served to educate the people of India out of the very common mercantilist fallacy, namely, that a favourable trade balance or excess of exports over imports is necessarily a good thing, and that an excess of imports is necessarily an evil thing. This excess of exports has been looked upon by some people as a measure of the tribute paid by India to England owing to her political subjection. For all the outgoings represented by this excess of exports, India of course receives some kind of return, and they can all be accounted for, as we have already seen, by various items of receipt. However, as the Spanish proverb has it, 'the accounts are all right but the treasury is empty'. The real point is not whether some kind of equivalent is received, but whether the return is in every way adequate.

Sir Theodore Morison defines the 'drain' as that portion of India's debits for which in any given year she receives no material equivalent in goods or money. He, however, forestalls an objection to this definition to the effect that in any given year the excess of exports may appear less than it actually is, because a foreign loan may have been contracted and received in the form of imports of various kinds, and this would reduce to that extent the real excess of exports to be accounted for and justified. The loan will have to be repaid in subsequent years and will then cause an increase in exports and in the amount of the 'drain', and therefore does not represent a real gain. In order to meet this objection, Sir Theodore Morison takes the 'drain' to mean potential drain, that is to say, that portion of India's debits, as they would have been in the absence of foreign loans, for which in any given year she receives no material equivalent. However, the first of these definitions is preferable to the second. Because we are less concerned with an accurate appraisement of the amount of the 'drain' than with a general discussion as to how far the various items accounting for it can be regarded as adequate returns, and as interest on debt is one of the most important of these items and raises important

expenditure, remittances of emigrants and immigrants, etc.; reparations in cash and other Government receipts and expenditure. 4. Gold (coin and bullion). The Capital items include long-term and short-term operations of the Government of India (including municipal issues). Unfortunately no information is available concerning private assets and liabilities abroad. It is very desirable that the Government of India should make fuller and more accurate figures available (as in the case of figures published by the British Board of Trade in the United Kingdom) and include them in the annual *Review of the Trade of India* for general information.

INDIA'S BALANCE OF PAYMENTS

In lakhs of rupees

	Pre-War average	War average	1932-3	1933-4	1934-5	1935-6	1936-7
Exports of Indian merchandise (private) ...	+2,19,50	+2,15,97	+1,32,27	+1,47,25	+1,51,67	+1,60,52	+1,96,13
Re-exports of foreign merchandise (private) ...	+4,62	+8,14	+3,22	+3,42	+3,55	+3,76	+6,24
Imports of foreign merchandise (private) ..	−1,45,85	−1,47,80	−1,32,27(*a*)	−1,15,00(*a*)	−1,31,80(*a*)	−1,33,75(*a*)	−1,24,60(*a*)
Balance of trade in merchandise	+78,27	+76,31	+3,22	+35,67	+23,42	+30,53	+77,77
Gold (private)*	−28,87	−7,81	+65,52	+57,05	+52,54	+37,35	+27,85
Silver (private)*	−7,21	−2,99	−73	−1	−37	−1,27	−13,59
Currency Notes (private)	...	...	+14	+19	+37	+29	+24
Balance of transactions in treasure (private) ...	−36,08	−10,80	+64,93	+57,23	+52,54	+36,37	+14,50
Total visible balance of trade	+42,49	+65,51	+68,15	+92,90	+75,96	+66,90	+92,27
Purchase of sterling by the Reserve Bank of India(*c*)	−41,35	−34,96(*b*)	−48,18	−59,97	−49,82	−45,58	70,87
Sales of sterling by the Reserve Bank of India(*d*)	+5	+5,50	...	...	...	...	...
Transfers of Government securities ...	−87	−38	−13	−11	+32	−56	−18
Interest drafts on India in respect of Government of India securities	−44	−30	−32	−36	−28	−31	−29
Balance of remittance of funds	−42,61	−30,14	−48,63	−60,44	−49,78	−46,45	−71,34
Total visible balance of accounts (payments) ...	−12	+35,37	+19,52	+32,46	+26,18	+20,45	+20,93

* Excludes transactions which do not enter into the balance of trade.

(*a*) Exclusive of the value of railway materials imported direct by State Railways working under the company management, which was not paid for in the ordinary way and was not, therefore, taken into account in arriving at the balance of trade.

(*b*) Includes Rs. 85 lakhs, being the funds supplied by the Government to finance wheat purchases.

(*c*) Figures for years prior to 1923-4 represent Council Bills and T.T. paid in India. From 1925-6 figures relate entirely to sterling purchases.

(*d*) Figures for previous years given against this item represent sterling transfers on London sold in India.

issues, it would be inadvisable to accept a definition which would compel us to leave it out of consideration.

§20. **The Home Charges.**—India's excess of exports over imports is largely accounted for by what are called the Home Charges.

The following figures show the great growth of the Home Charges between 1859-60 and 1933-4.[1]

Gross Sterling Expenditure in England

Year	Amount	Year	Amount	Year	Amount
	£		£		£
1859-60	5,042,945	1913-14	20,311,673	1928-9	29,744,993
1869-70	7,677,850	1918-19	23,629,495	1929-30	31,558,715
1879-80	14,543,277	1922-3	31,800,179	1930-1	31,423,147
1889-90	14,848,923	1924-5	31,888,776	1931-2	30,899,333
1899-1900	16,392,864	1926-7	29,507,472	1932-3	29,556,401
1909-10	19,122,916	1927-8	28,864,765	1933-4	28,862,177

The principal items of expenditure (charged against revenue in England in sterling) included in the Home Charges are as given in the statement on p. 271.[2]

We will exclude from the present discussion the payment on account of stores purchased on behalf of India in England, because the stores are a material equivalent and figure in the returns for imports. We have already seen that it is an arguable point whether these purchases of Government stores could not be effected more cheaply and whether a larger reliance on the Indian market for their supply is not feasible. But in the 'drain' controversy we are concerned with that part of India's debits in any given year for which (i) *in that year* no equivalent, material or immaterial, is received, as well as (ii) that part, for which the equivalent received in that year is *immaterial*, i.e. not in the form of material goods or money.

[1] Figures up to 1918-19 have been taken from Shah, *Sixty Years of Indian Finance* (second edition), pp. 187-8, and those for subsequent years from the *Statistical Abstract, 1926-7* and *1933-4*.

[2] Compiled from the *Statistical Abstract for British India for 1933-4*. Table No. 63.

Principal Heads of Expenditure in England (1933-4)	Central and Provincial
	£
Direct Demands on the Revenue :	**154,291**
Railway Revenue Account :	
State railways:	
Interest on debt	8,648,465
Interest on capital contributed by companies and Indian States	938,955
Miscellaneous railway expenditure	87,421
Total ...	**9,674,841**
Irrigation : Other revenue expenditure financed from ordinary revenues	**62,827**
Debt Services :	
Interest on debt other than that charged to railways ...	6,113,742
Interest on other obligations	43,476
Total ...	**6,157,218**
Civil Administration	**1,654,379**
Pensions and allowances :	
Territorial and political pensions	7,385
Superannuation allowances and pensions	2,596,065
Total ...	**2,603,450**
Stationery and Printing	**55,464**
Defence Services :	
Effective[1]	4,431,388
Non-effective	3,744,817
Total ...	**8,176,205**
Currency and Mint	**6,305**
Civil Works	**122,562**
Miscellaneous	**194,635**
Total expenditure charged against Revenue ...	**28,862,177**

§21. **Payments in connexion with foreign loans.**—One of the most important items in the Home Charges is interest on debt which has arisen in consequence of Government borrowings in England for financing railways, irrigation works, etc. The various questions relating to the employment of foreign capital in this country have

[1] Effective charges include payments for British forces, furlough allowances, troop service and passage money, etc., and non-effective charges include payments in connexion with retired pay, pensions, etc., of British forces and pay and pensions of non-effective and retired Indian officers.

already been discussed,[1] and it should now no longer be necessary to emphasize that borrowing money from abroad is not necessarily an evil, but that, on the contrary, foreign loans are often to be regarded as 'highly satisfactory incidents of economic development'. Many countries which are rich in national resources but poor in capital find it necessary and profitable to borrow from other countries, and some of the debtor countries like Canada are amongst the most prosperous in the world and are getting more and more prosperous with the help of foreign capital. It is obviously absurd to describe the interest on these loans as a 'drain', and since it is the interest on foreign debt that figures most prominently in the Home Charges as well as in the rest of India's disbursements abroad, Sir Theodore Morison proposes to substitute the colourless expression, 'foreign payments' or 'net foreign payments' for the misleading word 'drain', which suggests that these payments are harmful to the country. He argues that this part of India's indebtedness at any rate cannot be regarded as a drain on the country's resources caused by her political connexion with England. For even if she had been outside the Empire it would have been necessary for her to raise these loans for the purpose of developing her resources. The fact that these debts are incurred in England has nothing whatever to do with India's political subjection to England. The debts are raised in London because London happens to be the cheapest money market in the world. It is further contended that the political connexion with England, far from being a handicap to India, is of distinct advantage to her in this respect, because it has raised India's credit abroad and has enabled her to borrow on more advantageous terms than would have been possible otherwise. The English Government does not directly guarantee India's credit, but the British Government in India has, by ensuring a stable administration and by promoting the economic development of the country, improved her credit abroad. India is thus able to raise foreign loans at perceptibly lower rates than a number of other countries like Japan, and this is a continually increasing advantage, because, for a long time to come, India will have to borrow capital on a large scale, in order to be able to proceed satisfactorily with the task of industrialization on which she has set her heart; and even if she is able to obtain an advantage of no more than one per cent on the rate of interest, she will make a clear saving of one million pounds on every hundred million pounds that she borrows. The statement, however, that India has been able to borrow more cheaply than other countries has been

[1] See vol. I, ch. xiii.

challenged, and it is pointed out that even the South American Republics have not been at an appreciable disadvantage in this respect. But whether this is so or not, we must decline to be drawn into the purely hypothetical question as to whether an independent India would have been able to obtain loans on terms not very different from those on which she borrows at present. We must limit ourselves to what is rather than to what might have been, and what we are called upon to declare in the present discussion is whether, with better management, the actual burden of the debt, both as regards principal and interest, could not have been appreciably reduced. In this connexion we shall restrict ourselves to the consideration of the most representative as well as the most important of our borrowings, namely those for railway construction in this country. The various issues that would be relevant are, whether all the railways that have been built were required in the best interests of the country, and whether in some cases the need for transport facilities could not have been met more cheaply by other modes of transport such as roads and canals; whether to some extent the expenditure on railways was not at the sacrifice of other more deserving claimants for public funds like irrigation works; whether the inducements offered to foreign capital in the shape of guaranteed rates of interest were not excessive; and whether the railway system was worked as efficiently and cheaply as possible with a consistent regard for national interests. All these questions have already been discussed and we need merely repeat here that in all these respects mistakes have been committed, and so far our payments in connexion with these loans cannot be said to be compensated fully by economic equivalents. We may admit that the railways have been on the whole 'the harbingers of economic prosperity' in India and that the actual advantages, direct as well as indirect, more than outweigh the cost of the construction. But the real point at issue is whether these great benefits from railways have not been secured at a needlessly heavy cost.

Payments in the form of interest and profits on the foreign capital which has sought investment in this country without Government intervention and mediation do not appear under the Home Charges, but they account for a substantial portion of our excess of exports. Here again the question resolves itself into a discussion of the advantages and disadvantages of foreign capital in India, and we can only refer the reader to the relevant sections where this subject has been treated.[1] We had there occasion to

[1] See vol. I, ch. xiii, §§13-19.

note that along with some great and undoubted advantages, certain serious disadvantages have resulted from the unrestricted admission of foreign capital, and therefore the statement that ' India illustrates in its most obvious form the advantage of borrowing foreign capital',[1] cannot be accepted without reservation.

§22. **Civil and military services.**—We now come to that part of our payments which is made in respect of civil and military services. Here the question whether we get an adequate return for our payments will depend upon the manner in which we answer the following questions. Is the European agency employed in this country indispensable, and if so to what extent? Whether the salaries that are at present deemed to be necessary to attract the requisite type of European in the various branches of public service are not too high, and whether the process of Indianization has gone as far as it might, without endangering efficiency or bringing in its train other serious disadvantages? These questions will be answered differently by different people. But there is a very strong feeling that on all these accounts India's expenditure is much higher than it need be. The demand for the substitution of an Indian for a European agency wherever possible is not based merely on the ground of its relative cheapness. There are other considerations which are equally important. For example, there is the consideration that the experience of the Indian officer, unlike that of the European officer, is not lost to the country on his retirement. Further the relative inferiority of the Indian, wherever it must be taken as established, can in many cases be accounted for by the lack of adequate opportunity given to the Indian. What is more important than anything else, however, is that it is the Indian's birthright to be preferred in civil and military employment in his own country, even where he is slightly inferior to the European, and much more so when he is quite as fit.

In connexion with the military charges, another question, apart from that of Indianization, is whether the strength of the army at present maintained in India is not above her real requirements. The non-official opinion is that the army is bigger than is required for purposes of Indian defence. On the other side, however, it is contended that, even supposing the expenditure on the army in India is larger than it need be from the purely Indian point of view, India is on the whole a gainer. For she contributes only a small sum towards the upkeep of the British Navy,[2] whose services are indispensable for protecting her from invasion. If India were

[1] Morison, op. cit., p. 218.

[2] This contribution ceased from 1 April 1938. See ch. xi.

called upon to look after her own naval defence, she would have to spend a very much larger amount on her navy. But, on the other hand, it must be remembered that the British Navy is not maintained entirely for the purpose of guarding India's shores from invasion. Australia, for example, benefits perhaps even more than India from the British Navy, though her present contribution towards it is far from commensurate with the advantage enjoyed by her. Nor is she asked to maintain an army of a strength beyond her actual requirements for Imperial uses. The principle according to which the strength of the Indian army ought to be determined is that of making it just adequate for the defence of the country, and this furnishes the only test to be applied in deciding whether the military expenditure of India so far as it is due to the size of the army alone is excessive or not.[1] It is indeed unreasonable to expect that England should continue without complaint to bear the greater part of the expenditure on the navy whose services are available not only to herself but to every other part of the Empire, and in the future, proposals will probably be made in order to distribute expenditure amongst the different parts of the Empire so as to relieve England of the excessive burden of her responsibility in this connexion. It would, however, be absurd to suggest that each of the constituent members of the Empire should contribute a sum representing the full benefit derived by it from the British Navy. The capacity of each member to bear any additional burden would be a more reasonable criterion, and the comparative poverty of India would be a valid plea for a moderate charge being levied upon her. Even so, however, it is probable that her contribution would have to be more substantial than at present, and if matters are properly put to her, she will not and ought not to grudge this. But the whole question of the naval defence of the Empire requires to be treated separately on its own merits and should not be mixed up with the question as to whether the present military expenditure of India is not capable of being appreciably reduced. If the Indian Army is meant purely for the purpose of securing freedom for the country from external aggression, its size, personnel and organization are matters which must be determined on other principles than if it is meant for

[1] The size of the Indian army is larger than it need ordinarily be, also, because it is required for internal use and is not restricted to its legitimate function of protection against external aggression. Another common ground of complaint in connexion with the army is the system under which the Government of India is required to pay the cost of training British recruits who are later drafted to India. These are known as 'capitation charges'. See, however, ch. xi.

Imperial purposes. The Assembly repudiated the suggestion underlying the Report of the Esher Committee of 1919 that the Indian Army is to be regarded as part of the total armed forces of the Empire. Actually, however, the army has been frequently used for Imperial purposes, and the contention that, if it is intended to persist in this policy, part of India's military expenditure should be borne by England, does not appear to be unreasonable.[1]

§23. **Profits of bankers, and of shipping and insurance companies.**—Other services than those noticed above for which also India has to make a payment abroad and which are not exhibited under the Home Charges are those of foreign bankers, European shipping and insurance companies, etc. It is one of the cherished aspirations of the Indian people to be able before long to do much of this work for themselves. To say that this is a commendable ambition is not to forget the fact that even wealthy countries sometimes find it advantageous to buy such services from foreign nations. For example, the United States used to be largely indebted, at least before the War, to the principal European Powers for marine transport service, banking, insurance, and other financial and commercial services. But the plea that India should learn to rely on herself in these matters is based on the idea that, by so doing, she will certainly reap great economic and other advantages, while lessening the magnitude of the ' drain ' .

§24. **Some basic assumptions of the ' drain ' controversy.**—As a set-off against the various losses incurred by India on account of the ' drain ' it is sometimes urged that, after all, England has conferred on India the inestimable boon of peace and has made possible an orderly development of the country in all directions and that, therefore, India's losses due to the ' drain ' are as dust in the balance when weighed against these blessings. On this plea, however, it would be possible to justify every kind of Government extravagance and unfairness. A large number of thinking people in this country would readily admit the great advantages to India of the British connexion. But precisely because they are immeasurable, no attempt should be made to measure them. They should not be dragged into a discussion which is occupied with more definite and calculable, though perhaps less fundamental, matters; just as we should also refuse to consider as a part of this controversy, the incalculable, though none the less real, advantages which England derives from India. We may be able to compute roughly the advantages which her business men derive from the

[1] This principle has recently been partially accepted by the British Government. See ch. xi.

scope which India offers for their activities and enterprise. But by what calculus shall we estimate the gain to England from the enormous increase in her international prestige owing to her possession of India; or how shall we attempt to fix the value, in terms of pounds, shillings and pence, of the glow of pride and power which Englishmen feel when they contemplate this magnificent empire; or of the value of India to England as an unrivalled field for the training of her soldiers, statesmen and administrators? The question of the drain, if it is going to lead to any useful conclusions, must leave out of consideration all these impalpable elements.

As against those who are impressed with the great benefits which British rule has conferred on India, there are others who feel that nothing can really be held to compensate for loss of political freedom. But those who are of this opinion have obviously no right to engage in a discussion of this kind. For the 'drain' theory seeks an answer to the question, how far the compensation which India obtains for the outgoings represented by the excess of exports is adequate, and in so framing the question admits the possibility of compensation. If arguments with reference to the advantages of *Pax Britannica* are to be ruled out of court, so must arguments about the degradation involved in the loss of liberty.

§25. **Economics and politics of the 'drain' theory.**—From the foregoing discussion it will have been clear that much of the 'drain theory' in its present form has come to be a somewhat diffused and not very effective criticism of British administration in India. Its association with political agitation and propaganda has been responsible for a good deal of unsound economics. One of the earlier crudities of the theory was to suppose that the annual drain was a tribute exacted by England from India in the form of actual treasure. This was, however, seen to be in flat contradiction with facts, which showed a large net Indian import of gold and silver. The next stage was to assume that the whole of the excess of exports represented so much net loss to the country. This position was also abandoned and, as we have just seen, it is now usual to admit that some return is being received in the form of various kinds of services, though it is maintained by many people that India is required to pay too heavily for them. As a result of these successive modifications, the 'drain' theory has lost much of its original full-blooded character. The analysis undertaken in connexion with it, however, still remains useful as indicating various directions of urgent reform. Nevertheless we are of opinion that the word 'drain' has been one of the most heavily worked in the whole phraseology of Indian Economics, and it has been invoked too

often as an explanation of everything that is 'rotten in the state of Denmark'. It has served to summarize all the woes and burning thoughts of at least two generations of patriots. To many Indians of the generation of Dadabhai Naoroji, the use of the word 'drain' also seems to have appeared singularly apt in view of a certain famous utterance of a rather cynical Secretary of State, who had a fatal facility for incisive language, and who talked of the necessity of 'bleeding India'.[1]

Economics in this country began by being an ally of politics, and the 'drain' theory was the first product of the association between the two. It suggested that the intense poverty of India was very largely, if not entirely, due to the tribute exacted by England from India. We have seen above how the 'drain' theory has been much improved of late by the introduction of many necessary qualifications and how it still points to the existence of a number of real grievances. It does not, however, furnish anything like a complete explanation of Indian poverty. The first Indian thinker to see the necessity of emphasizing many other more important causes was Ranade, who was a path-breaker in this as in so many other matters.[2] Later writers have perhaps not always shown Ranade's insight and his exquisite sense of proportion.

§26. **Land frontier trade.**—India has an extensive land frontier (about 6,000 miles) on the north-west and north-east, considerably exceeding her sea-coast in length. But at many points it offers great difficulties for commerce owing to obstacles such as dense and impenetrable forests and inaccessible mountains. As there are very few openings or passes, like the Bolan Pass on the north-west frontier, communication with trans-frontier countries is difficult. In our historical survey of India's foreign trade we have already drawn attention to the ancient character of her land frontier trade, which was fairly brisk during the Mogul period. In more recent times, the position in respect of trans-frontier communications has been considerably improved, especially on the north-west frontier. Though the principal motive in laying out the frontier railway was strategic, it is also serving as an artery of commerce. The principal trans-frontier countries with which India has trading

[1] Lord Salisbury, Secretary of State for India, said in 1875: 'As India must be bled, the lancet should be directed to the parts where the blood is congested, or at least is sufficient, not to those which are already feeble from the want of it.' It was not so much the unusual frankness which characterized this utterance nor the idea it conveyed (which after all was not so very wicked when the whole context is considered) as the sanguinary language employed, that caused so much resentment in India and was responsible for the notoriety which it attained.

[2] See also D. A. Shah, *The Indian Point of View in Economics*, p. 12,

connexions are Afghanistan, Central Asia, Iran, Nepal and Tibet. The course of the land frontier trade during the years ending 1924-5 is summed up in the following table: the figures include trade across the Burmese frontier, with the Shan States, Western China and Siam.

In crores of rupees

	1916-17	1918-19	1920-1	1924-5	
Imports ...	12·81	15·96	18·16	23·08	Discontinued from April 1925
Exports ...	10·34	14·87	15·81	18·73	
Total land trade ...	23·15	30·83	33·97	41·81	

These figures, while they are insignificant in comparison with the total annual sea-borne trade of India, yet reveal a steady progress, which is likely to be quicker with further improvements in trans-frontier communications.

The feature of the existing system of registration of land frontier trade of India (excluding Burma) which came into force from April 1925, is that only the traffic in certain selected commodities at certain railway stations adjacent to the more important trade routes across the frontier is recorded. (This principle was also extended to Burma with effect from 1 April 1926.) It is estimated that the bulk of the inward traffic at these stations is intended to be transported beyond the frontier, and the bulk of the outward traffic consists of goods which have come from beyond the frontier. It is impracticable however to specify the exact proportion of the actual frontier trade to the total trade registered at these stations. Arrangements have been made since 1 February 1937 for separate registration of trade between India and Afghanistan at Torkham, Thal and Chaman. Values are also recorded in this case. The principal commodities at present imported from the trans-frontier countries are food-stuffs such as wheat, grain, pulse, and rice; fruits, vegetables and nuts, especially from Afghanistan; raw wool from Afghanistan and Tibet; raw jute and oilseeds from Nepal; living animals, principally from Nepal; raw silk, etc. By far the most important exports are cotton goods, foreign and Indian; cotton yarn; grain and pulse; sugar; raw cotton; iron and steel (including hardware and cutlery); petroleum; leather manufactures; silk goods; tea; salt; tobacco, etc.[1]

It would be manifestly to the advantage of India to develop this

[1] *Review of the Trade of India* (1936-7), p. 163.

branch of her external trade to the utmost possible extent, especially as, with the progress of the manufacturing industries in India, the importance of nursing trans-frontier markets will be greater than ever before.

§27. **International trade and economic prosperity.**—The aggregate volume of India's trade is sufficiently large to entitle her to the fifth place among the countries of the world, which stand in the following order: the United Kingdom, the United States, France, Germany, India. As regards *per capita* trade, however, India stands very nearly at the bottom, as the following table, relating to the period before the world trade depression set in, shows.

Foreign trade per head of population (special trade in merchandise only)[1]

In U.S.A. dollars

Country	1913	1921	1925
Australia	155	175	255
Canada	142	258	244
Denmark	134	233	233
United Kingdom	126	253	208
Belgium	209	212	192
France	74	130	105
Germany	74	48	80
United States	43	63	79
Japan	12	38	33
India	4·3	7·0	7·3
Russia	8·5	3·2	4·7
China	1·6	3·7	3·2

It is obvious that in the case of a large country like India, with a huge population, a much more considerable increase in the volume of the total trade is required to show a given amount of growth per head than in the case of small countries.

We cannot take the *per capita* foreign trade of a country as an infallible index of economic prosperity. For if we did we should, for example, conclude that the United Kingdom is considerably richer than the United States. And yet the true position is precisely the reverse of this. It would scarcely be an exaggeration to say that the very existence of the United Kingdom depends on a prosperous foreign trade, whereas to the United States her foreign trade is of slight importance as compared to her internal trade. And

[1] *League of Nations Memorandum on Foreign Trade Balances*, vol. I, p. 150 (quoted by Mr S. C. Bose in his M.A. thesis, *The Foreign Trade of India*).

generally speaking, it will be found that international exchange is of far greater importance to small than to big nations. However, the safest thing for the student is to remember that international trade is governed by the principle of comparative costs and not by the wealth or poverty of the countries engaging in it. The size of the aggregate, and to a smaller extent the *per capita*, income may sometimes serve to corroborate conclusions in regard to the relative economic strength of nations arrived at by the application of surer tests than the *per capita* income; but there is much risk in making it the sole basis for such inferences. Dr Marshall has treated the whole question in all its aspects with his usual fulness and ability, and we may be pardoned for quoting freely from him. Comparing India with the West Indies in the days before England had yet become the workshop of the world, he points out that 'when natural and artificial causes were combining to give the West Indies nearly a monopoly of the production of sugar, some of these islands imported not only all their clothing and other manufactures, but also nearly all their food. On the other hand, India had at the time but little foreign trade, in spite of her vast population and the high value which Europe placed upon many of her products. For she had little need of European products; she could herself supply most of the things which she desired to have; and Europeans could not get access to more than a narrow fringe of the large and rich land. Consequently while the foreign trade of the West Indies was for a time one of the largest in the world, that of the whole continent of India remained small '.[1] All the same, however, India was a wealthier country than the West Indies. Dr Marshall has also observed that ' a country's foreign trade is likely to be increased by rapid advance in those industries which are already ahead of similar industries in other countries; because such an advance increases her power of exporting at a profit. But her foreign trade is likely to be lessened; or at all events its growth is likely to be checked by an advance in those industries in which she is relatively weak, because such an advance will tend to diminish her need of exports '. A large *per capita* foreign trade may ' indicate that a nation is prosperous and enjoys comforts and luxuries by participating in an international exchange of commodities, or, on the other hand, it may indicate that the people live in a poor and unproductive territory and are compelled to give services and import bare necessities, articles of simple food, and clothing, fuel and building material and sometimes even drinking water, as in the case of Aden in southern

[1] Marshall, *Industry and Trade*, p. 25.

Arabia '.[1] At the same time, however, so far as actual experience goes, great national trade has almost invariably been an evidence of high industrial energy, especially when we are considering not so much a large *per capita*, as a very large aggregate, external trade. ' For the same energy of character that makes a nation eminent in industry is likely to make her traders alert to seize every opportunity of bringing the products in which she excels to the notice of countries that cannot produce those things with as much relative ease and efficiency as they can other products, which are in demand in her own market but cannot be produced there with as much ease. The case is specially strong when the exports consist largely of high grade products.' A large aggregate trade commonly indicates high industrial efficiency. It shows that, in the country in question, ' each sort and degree of skill is set to the work for which it is specially adapted; plant is improved rapidly; and that which is no longer the best of its kind is quickly thrown out, often to be exported to countries whose industries are still backward '.

In the light of the above considerations we may conclude that the great increase in India's foreign trade in modern times owing to the extension of facilities of railway and steamer transport must not be regarded as a sign of industrial pre-eminence but at most as a necessary preliminary to it. If India develops her own manufactures, this may result, at least in the beginning, in a considerable diminution of her foreign trade, as she will herself be producing the manufactures which she at present imports from abroad. It may, however, happen that in the future her manufactures will develop to such an extent that, after replacing foreign manufactures in the home market, they will overflow her boundaries and spread in the outside world. In fact India's case may be cited in illustration of the uncertain connexion between foreign trade and economic prosperity. While her first step forward in economic progress has been accompanied by a considerable extension, her next step will probably be marked by a decline of her international commerce, and the final stage in her economic evolution may again be characterized by an increase in her foreign trade.

Internal Trade

§28. **(i) Coasting trade.**—We have already indicated the present position and the future importance to India of her coastal

[1] ibid., p. 14.

trade in our discussion of the proposal to reserve the coastal trade for Indian shipping. The coastal trade may be regarded as a part of the inland trade of the country, though it also includes a small amount of foreign trade.[1]

The following table shows the value of private merchandise (Indian and foreign) imported into and exported from the several maritime provinces of British India from and to Indian ports (British and foreign).

Coasting Trade (In thousands of rupees)[2]

	1918-19		1935-6	
	Imports	Exports	Imports	Exports
Bengal	14,16,28	11,46,70	15,03,60	9,93,93
Bihar and Orissa ..	24,33	10,67	9,99[3]	12,92[3]
Bombay	38,60,35	21,34,04	18,54,75	22,28,72
Sind	8,09,05	6,02,73	9,03,27	8,52,96
Madras	9,52,06	8,58,06	21,30,05	9,33,07
Burma	16,95,11	20,22,48	9,93,52	34,09,35
Total ...	87,57,18	67,74,68	73,95,18	84,30,95

Including the value of the exports and imports of Government stores and of treasure, the total coastal trade was valued at Rs. 1,66,59 lakhs and Rs. 1,61,84,59 lakhs in 1918-19 and 1935-6 respectively. The trade between Burma and the provinces of India is of special interest as land communication with Burma is very difficult. The total value of imports into Burma was Rs. 10,93 lakhs and of exports Rs. 34,92 lakhs in 1936-7. The principal coastwise imports into Burma are coal, cotton piecegoods, jute bags, pulse, betel-nut, iron materials, wheat flour, raw tobacco, cigarettes, groundnut oil, dried fish, tea, and sugar, while the principal exports from Burma are rice, kerosene oil, petroleum, candles, lac, teakwood, timber, gram, pulses, etc.[4]

[1] In 1935-6 out of the total value of private merchandise imports, viz. Rs. 73·95 crores, Indian merchandise was valued at Rs. 68·42 crores and foreign merchandise at Rs. 5·53 crores; and similarly, out of a total value of exports of Rs. 84·31 crores, Indian merchandise was valued at Rs. 77·18 crores and foreign merchandise at Rs. 7·13 crores.

[2] See *Statistical Abstract for British India* (1935-6), Table No. 274.

[3] Orissa only.

[4] For further details see *Review of the Trade of India* (1936-7), p. 165.

The total foreign and coastwise trade (imports and exports) of the eight principal ports of India in 1935-6 was as follows.

Total Trade of Eight Principal Ports (In lakhs of rupees)[1]

	Foreign		Coasting		Total	
	Pre-War average	1935-6	Pre-War average	1935-6	Pre-War average	1935-6
Bombay ...	1,13,15	87,85	32,30	41,65	1,45,45	1,29,10
Calcutta ...	1,41,06	98,96	18,72	23,27	1,59,78	1,22,23
Rangoon ...	29,93	28,18	19,03	39,59	48,96	67,77
Karachi ...	38,87	32,43	9,00	17,55	47,87	49,48
Madras ...	16,80	20,82	2,81	8,20	19,61	29,02
Cochin ...	2,72	6,08	3,56	7,37	6,28	13,45
Tuticorin ...	5,56	3,07	1,67	6,39	7,23	9,46
Chittagong ...	5,71	6,06	1,76	2,38	7,47	8,44

These figures show that Bombay, Calcutta and Rangoon to a very large extent, and Karachi and Madras to a smaller extent, account for the bulk of the total foreign and coastal trade of India.[2]

To ensure the fullest possible development of the coastal trade in India, a comprehensive programme of port development, the building up of an Indian mercantile marine and a proper co-ordination between coastal and railway traffic are necessary, but these are topics on which we have already expatiated at considerable length.[3]

§29. **(ii) Inland trade.**—India, like America, but unlike the United Kingdom, is more vitally interested in her internal than in her external trade. This is not surprising in view of the continental dimensions of the country, her teeming population, her diversity of physical and climatic conditions and her vast and varied natural resources. In modern times the extension of improved means of communication and transport has added greatly to the volume of the internal trade, and this process will be quickened by a general economic advance and the progress of organization, which will increase the scope for exchange between town and country.

The great importance of the internal trade of India is insufficiently appreciated. The imposing figures of the exports of

[1] These figures include all foreign and coasting trade, except Government stores, in merchandise. See *Statistical Abstract for British India* (1935-6), Table No. 260.

[2] For an interesting account of the trade of the principal ports see Vera Anstey, *Trade of the Indian Ocean*, pp. 79-85.

[3] See ch. v.

cotton, jute, rice, wheat, oilseeds, etc., represent only a moderate proportion of India's total production, of which some idea has already been given; though of course it is true that not all that remains after export is offered for sale, for a part is directly consumed by the producers, as in the case of the peasant proprietors who consume a large portion of the food-stuffs raised by them. The great importance to India of her internal trade is brought out by the consideration that, 'if India's total agricultural produce is taken into account, calculations show that for every acre of land producing goods, whether grain, oilseeds, fibres, tea, etc. for export, eleven acres are cultivated for local consumption '.[1] To the agricultural production which remains in the country for internal consumption and exchange must be added the non-agricultural produce, such as mineral production and manufactures, of which only a small percentage is exported abroad.

No accurate and reliable statistics are available regarding the volume and the value of the inland trade of the country. Fairly satisfactory data are available regarding the coastal trade, the bulk of which, as said above, may be regarded as part of the internal or the inter-provincial trade of the country. But so far as the inland trade proper goes, sacrcely any information beyond the statistics of the goods traffic of railways was available for some years. Until 1923 the Department of Statistics used to publish the compilation *Inland Trade (Rail and River-borne)* of India annually, and all the provinces used to issue similar publications. These gave the import and export trade in staple articles of each of the five or six blocks into which every province was divided; and the imports and exports of eighteen bigger blocks forming the trade divisions of India as a whole. The figures related to quantity only; the figures of value, given in a few cases, were admittedly very rough. The internal trade returns were defective in other respects also. Trade within a block was not recorded; there was obvious evasion on railways; and trade by road, which is not negligible, was not taken into account.[2] However in spite of their defects these statistics were of some utility, and it was unfortunate that, except in one or two provinces, they were discontinued, as was also the publication *Inland Trade (Rail and River-borne)* in 1923 on the recommendation of the Retrenchment Committee. The Economic Enquiry Committee rightly pressed for the revival of the publications of the internal trade returns, and for their improvement so as to bring them into line with the more up-to-date statistics of the same kind maintained by countries like the United States. It is gratifying that the

[1] See Worswick, *The Economic Resources of the British Empire*, p. 145.
[2] *Economic Enquiry Committee Report*, p. 13.

Government of India have since April 1933 revived the publication of these statistics, by issuing *Accounts relating to the Inland (Rail and River-borne) Trade of India*, every month, offering a summary view of the inland trade of India during each month together with running totals from the beginning of the official year. The new series, which is published by the Department of Commercial Intelligence and Statistics, retains in essentials the form of the older publication. The statistics are given relating to the inland trade of India carried by the railways and the steamer services, and represent the movement of trade into and from a province, taken as a whole, or a chief port or ports, the trade of which is registered separately from that of the trade of the province in which such port or ports may be situated. The trade dealt with in these accounts falls into one or other of the following categories: (*a*) the trade of a province with other provinces, (*b*) the trade of a chief port with the province in which it is situated, and (*c*) the trade of a chief port with other provinces. Goods carried from one station to another within the same province or principal trade block are not registered for the purpose of these accounts. For the purpose of registration of these statistics the country is divided into 18 principal blocks as follows: (*a*) 9 blocks representing British provinces, (*b*) 4 representing the principal port towns, viz. Calcutta, Bombay, the Madras seaports and Karachi, and (*c*) 5 representing Indian States. The rail-borne trade is not registered in Burma. The statistics relate to quantities and denominations only, and figures of value are not given.[1] The net weights are given uniformly in standard maunds of 82 2/7 lb. The statistics in the new series are thus characterized by the same defects as in the case of the older one.

The table on p. 288 shows the total trade in each article between each province, and Indian State and chief seaport (in maunds) in the twelve months, 1 April 1936 to 31 March 1937.[2]

[1] As the railway and steamer invoices show only the figures of quantity, the statistics in the above accounts relate to quantities only. Owing to the great disparity between the prices for the same commodity in the different parts of the country it is not possible to work out the corresponding figures of value; and past experience shows that on whatever basis values are assigned, these are in most cases only a very vague approximation to the truth and should more often than not afford no basis for working out a true and correct balance of trade for the different provinces involved. See *Accounts relating to the Inland (Rail and River-borne) Trade of India*, March 1937, pp. 1-2.

[2] The total inland trade in the main commodities increased from 628,464 thousand maunds in 1933-4 to 736,839 thousand maunds in 1936-7, or by 17 per cent. This may be regarded as an index of the partial economic recovery of the country.

In the absence of full and dependable statistics relating to inland trade, no precise idea can be formed of its dimensions and of its relative importance as compared to the foreign trade of the country. According to *Inland Trade of India for 1920-1*, the total inland trade was estimated at nearly Rs. 1,500 crores, thus giving a proportion of $2\frac{1}{2}$: 1 between the domestic trade and the foreign trade.[1] Such figures as are available, however, leave no doubt regarding the small volume of the inland trade in relation to the size and the population of the country. With a fuller development of the economic resources of the country the volume of internal trade is bound to increase to many times its present size. It is also necessary to follow a policy of systematic development of the inland trade of the country having regard to the uncertain character of an external trade and the big drop in our export trade. The revival of our external trade will, of course, stimulate the internal trade. It is, however, desirable to bring about its extension apart from its connexion with the external trade.

§30. **Principal trade centres of India.**[2]—We may now fittingly conclude this chapter with a brief description of the principal trade centres of India, and follow it by a few words about commercial intelligence and trade organizations. In an account of the trade centres of India mention may first be made of the four principal harbours of India, namely, Calcutta, Bombay, Karachi, and Madras. Calcutta and Bombay are not only the principal ports but also the most important industrial centres of India. Bombay is further the chief distributing centre for western India for the large volume of imports of cotton manufactures. The trade of Bombay is preponderantly in Indian hands as contrasted with Calcutta, where it is largely under the control of Europeans. Karachi is the centre of the wheat trade. Madras also is a considerable trade and industrial centre but not comparable in importance to Bombay or to Calcutta. Apart from these four principal ports,[3] other big trade centres are Cawnpore, Delhi, Ahmedabad, Amritsar, Agra, Lahore, Benares, Lucknow, Nagpur, etc. Cawnpore, which is an important railway junction in the United Provinces, holds a central position, being situated half-way between Bombay and Calcutta, and is a convenient distributing centre for foreign and local goods. Delhi,

[1] K. T. Shah holds that this is an underestimate, and places the value of the inland trade of India at Rs. 2,500 crores. *Trade, Tariffs and Transport*, p. 122.

[2] See Cotton, *Handbook of Commercial Information for India* (third edition), pp. 62-113; also vol. I, ch. ii.

[3] Besides these principal ports there are others of some importance in Kathiawar: Bedi in the State of Navanagar, Okha (in Baroda State), Porbunder and Bhavnagar.

Inland (Rail and River-borne) Trade of India, 1936-7

Article	Maunds	Article	Maunds	Article	Maunds
Bones	4,670,723	(iii) Wheat	28,108,597	(ii) Vegetable oils	4,551,971
Cement	19,948,275	(iv) Wheat flour	5,915,029	Total	20,155,921
Coal and coke	397,816,680	(v) Other sorts	45,111,037	Oilseeds:	
Coffee	210,985	Total	129,232,800	(i) Castor	1,697,706
Cotton, raw:		Hemp, Indian, and other fibres (excluding jute)	1,745,812	(ii) Cotton	8,964,482
(i) Kapas	537,529	Hides, raw	1,996,223	(iii) Groundnuts	16,572,069
(ii) Pucca bales	28,669,595	Skins, raw	1,160,433	(iv) Linseed	7,044,948
Cotton raw total	29,207,124	Hides and skins, tanned and leather	586,823	(v) Rape and mustard	7,148,222
Cotton twist and yarn:		Jute, raw:		(vi) Til or jinjili	2,347,021
(i) Foreign	270,980	(i) Loose	1,286,834	Total	43,774,448
(ii) Indian	2,682,240	(ii) Pucca bales	36,938,390	Ghee	692,236
Total	2,953,220	Total	38,225,224	Salt	30,001,854
Cotton piece-goods:		Gunny bags and cloth	5,151,982	Saltpetre	509,863
(i) Foreign in bales	643,358	Iron and steel bars, sheets, girders, and other commercial forms of iron and steel.	39,317,288	Sugar:	
(ii) Foreign in boxes	517,462	Lac and shellac	1,245,607	(i) Refined and unrefined	24,987,659
(iii) Indian in bales	9,139,921	Manganese ore	21,213,374	(ii) Gur, rab, molasses, jaggery, etc.	15,400,310
(iv) Indian in boxes	220,239	Mica	259,986	Total	40,387,969
Total	10,520,980	Oil cakes	8,400,678	Tea	4,264,368
Dyes, tans and myrobalans	1,622,789	Oils:		Tobacco, raw	3,295,936
Fruits, dried	10,064,554	(i) Kerosene	15,603,950	Wood and timber:	
Glass	969,827			(i) Teak	2,098,835
Grain and pulse:				(ii) Other timber	12,990,084
(i) Rice in the husk	7,117,250			Total	15,088,919
(ii) Rice not in the husk	42,980,887			Wool, raw	770,426

now the capital of India, is the junction of nine railway lines and an important clearing house for the Punjab and the western districts of the United Provinces, particularly in cotton, silk and woollen piece-goods. Ahmedabad is, next to Bombay, the most important centre in the Bombay Presidency. Amritsar in the Punjab has not only a large entrepôt trade in piece-goods, but also does a large business in skins and hides; it is also well known for its carpet industry. Agra has considerable manufacturing industries connected with carpets, durries, embroideries and stone work, and is a collecting centre for the better qualities of hides. Lahore is the chief trading centre for the agricultural produce of the Punjab. Benares is mainly of interest as a considerable centre of the silk-weaving industry. Lucknow is commercially of interest as a distributing and collecting centre for the rich agricultural produce of Oudh. Nagpur derives its commercial importance from its weaving mills, cotton-ginning and pressing factories, and the extensive manganese deposits in its neighbourhood. In addition to these centres of trade, mention may be made of Jubbulpore, Mirzapur, Madura, Gwalior, Dacca, Srinagar, Sholapur, Amraoti, Hyderabad (Deccan), Allahabad, Jaipur, Baroda, Bangalore and Mysore.

§31. **Commercial intelligence and trade organization.**—The collection, careful analysis and judicious distribution of commercial and industrial intelligence has now come to be a necessary function of governments in civilized countries in view of the international competition in industry and commerce. Not a little of the prosperity of countries like Germany, Japan and the United States, is owing to their excellent system of commercial intelligence. Trade commissioners are appointed and consuls stationed in foreign countries, their main duty being to supply information about foreign markets to their respective countries. India is insufficiently equipped in all these respects. Though the Commercial Intelligence Department came into existence as far back as 1905, it was put in evidence before the Industrial Commission that there was no clearly defined channel through which information on commercial matters in the possession of the Government could be communicated, whether publicly or to individual applicants.[1] The Commission made several useful recommendations in this connexion, including the establishment of Indian trade agencies in other countries such as East Africa and Mesopotamia. The position today is somewhat more satisfactory than it was a few years ago. The Department of Commercial Intelligence and Statistics, which was reorganized in 1922, now forms a connecting link between the commercial public and the Government of India. It collects information bearing on

[1] *Industrial Commission Report*, par. 180.

overseas trade which may be of use to Indian firms; compiles and publishes statistics of all-India importance relating to trade, industry and so on. It answers trade inquiries, effects trade introductions and publishes in the *Indian Trade Journal* (the weekly organ of the Department) statistics and other information of commercial value. The Department keeps in touch with trade developments of interest to India. In the United Kingdom, through the medium of the Indian Trade Commissioner in London, who since 1926 has been assisted by the Trade Publicity Officer, opportunities as they present themselves in England for commercial publicity are utilized in India's interest. This step has led to some useful results. The Department of Commercial Intelligence and Statistics also works in close co-operation with the Indian Trade Commissioner in Hamburg. Since these appointments were made, arrangements have been made for the display of Indian goods at some of the important exhibitions and fairs on the Continent.[1] The Department of Commercial Intelligence is also in close touch with His Majesty's Trade Commissioners in India and the Dominions and with Consular Officers in the various parts of the world so as to stimulate the overseas demand for Indian produce and manufactures. The High Commissioner for India in London, whose office was created in 1920, has been saddled with much miscellaneous agency and financial work, of which the purchase of Government stores is the most important. He is therefore not in a position to be of much use for promoting Indian commercial interests abroad. The organization described above is chiefly concerned with making known abroad information regarding the possibilities of Indian markets for foreign goods. It is equally necessary, however, to supplement it by a similar organization for the purpose of making available in India information regarding foreign markets for Indian goods. New ground was broken in this direction by the Trade Mission which was deputed in 1928 by the Government of India in pursuance of a suggestion made by the Textile Tariff Board (1926) to explore the potentialities of certain export markets for Indian textile goods.[2] The Report submitted by the Trade Mission suggested the appointment of three Trade Commissioners for India to be stationed at Alexandria, Mombasa and Durban. The establishment of Indian trade agencies and of an independent Indian consular service, as in the case of the self-governing Dominions, would be well justified as helping to develop trade relations with foreign countries on lines most beneficial to India. In January 1930 the Government of India outlined a scheme which contemplated the appointment of six Trade

[1] See *India in 1926-7*, p. 209; and *India in 1927-8*, pp. 208-9.

[2] See *ante*, p. 38, and *India in 1928-9*, p. 198.

Commissioners, one each at Hamburg, Milan, New York, Durban, Mombasa and Alexandria. Accordingly an Indian Trade Commissioner was appointed at Hamburg in 1930. In 1935, a similar appointment was made at Milan. In 1937 an Indian Trade Commissioner opened his office at Osaka in Japan. Towards the end of December 1937 provision was made for an Indian Trade Commissioner for East Africa at Mombasa. Recently (June 1938) a new Indian Trade Commissioner opened his office in New York. The appointment of a Trade Commissioner at Alexandria is under investigation.[1]

§32. **Commercial organization in India.**—The most important and the best organized non-official commercial organizations in India are those formed by European merchants, such as the Associated Chambers of Commerce of India and the various Chambers of Commerce at Calcutta (1834), Bombay (1836), Madras (1836), Rangoon, Karachi and other principal centres. Their membership, except in Bombay, is preponderatingly European, though open to Indians also. This is but the natural outcome of the earlier start made by European traders in establishing commercial connexions between India and the West. In addition to the Chambers of Commerce there are also associations representing particular branches of trade, such as jute mills and cotton mills; and also those representing retail traders in the principal cities. Hitherto the Indian commercial community have suffered from lack of suitable organization for obtaining redress for their legitimate grievances, and it is a welcome sign of the times that Indian merchants are waking up to the necessity of organizing themselves. There are now several purely Indian associations, such as the Bengal National Chamber of Commerce, which is the oldest (1887) organization of the Indian mercantile community, the Indian Merchants' Chamber and Bureau, Bombay (1907), the South Indian Chamber of Commerce, Madras (1909), the Indian Chamber of Commerce, Calcutta (1925), and the more recently (1927) started Maharashtra Chamber of Commerce. There is also an All-India Federation of Indian Chambers of Commerce and Industry.[2] All these organizations can be of immense service in focussing commercial opinion in India and giving a lead to the Government in regard to problems affecting the commercial and industrial development of the country.[3]

[1] Viceroy's address to the Associated Chambers of Commerce, 20 December 1937.

[2] For an instructive and comprehensive account of the several Chambers of Commerce and Commercial Associations in India, see Cotton, op. cit., part iv.

[3] It may be noted here that some of the important Chambers of Commerce have been given representation on both the Central and Provincial legislative bodies.

CHAPTER VII

CURRENCY AND EXCHANGE—PART I[1]

§1. **Indian currency in the pre-British era.**—Since Akbar's time the currency in northern India had come to consist of the gold mohur and the silver rupee, which both weighed 175 grains troy. There was no fixed legal ratio between them, though each of the coins bore a fixed ratio to the *dam*, the copper coin of the Mogul Empire.[2] In southern India, which never came completely under the dominion of the Moguls, gold was the principal currency. Under Hindu rule, preference was generally given to gold, while the Mohammedans showed a predilection in favour of silver. When the Mogul Empire broke up and on its ruins arose a large number of independent states, many of them signalized their independence by striking a special coin, this being regarded as a mark of sovereignty. Though the old denominations were generally retained, there was every degree of variation as regards weight and fineness. So that when the East India Company came upon the scene, it found that the currency position was characterized by a bewildering multiplicity and variety of coins of gold and silver. It has been calculated that as many as 994 different coins made of gold or silver and of varying weight and fineness were current.[3] The services of professional shroffs (appraisers) had constantly to be requisitioned to ascertain the value of the coins held by the people. The East India Company found its commercial transactions seriously hampered by this chaotic condition of the currency, and thus began the series of experiments in currency organization in India, whose history it is our purpose to narrate in this chapter.

§2. **Four periods in the nineteenth century.**—We may divide the history of Indian currency in the nineteenth century into four periods[4]:—

(i) The first period (1801-35) is characterized by attempts to establish a uniform rupee as the only standard for the Company's possessions.

[1] This chapter will be mainly concerned with the history of the Indian currency and exchange system up to the appointment of the Hilton-Young Commission in 1925. The next chapter will deal with the various criticisms of the system and with its reconstruction on the lines suggested by the Hilton-Young Commission.

[2] B. R. Ambedkar, *The Problem of the Rupee*, p. 3.

[3] H. D. Macleod, *Indian Currency*, p. 13.

[4] See Findlay Shirras, *Indian Finance and Banking*, p. 93, *et seq.*

(ii) The second period (1835-74) is marked by efforts made to introduce a gold currency, and several proposals in this connexion were discussed, without, however, leading to the establishment of a gold standard and a gold currency.

(iii) The third period (1874-93) witnessed a continuous fall in the value of silver, making the exchange value of the rupee low and unstable. During this period there was considerable agitation for currency reform on the basis of international bimetallism.

(iv) The fourth period (1893-1900) is characterized by the closing of the Indian mints to the free coinage of silver and the subsequent linking of the Indian currency with the gold standard—a process completed in 1898 with the recognition of the British sovereign as unlimited legal tender side by side with the rupee, with the fixed legal ratio of 15 : 1 between them.

We shall now deal with these four periods in more detail.

§3. **The first period (1801-35).**—The first attempt of the East India Company at evolving order out of the prevailing confusion in currency resulted in a simultaneous issue of both gold and silver coins with the Company's stamp, and with a definite legal ratio, weight and fineness. But owing to the fluctuations in the market value of the two metals it was found impossible to maintain the ratio. Under the official ratio, gold was undervalued and was therefore displaced by silver. About this time Lord Liverpool published in England his famous *Treatise on the Coins of the Realm*, which enunciated the principle that only one metal should be the standard and unlimited legal tender, though other metals might also be coined and allowed to circulate at their market value. The Directors of the East India Company, seeking a way out of the currency muddle in India and influenced by Lord Liverpool's work, selected silver to function as the only standard in India. However, in 1806, in a dispatch to the Governments of Bengal and Madras, they took care to mention that their intention was by no means to drive gold out of circulation where it was the general measure of value. The Company tried to keep the ratio fixed between the rupee and the gold mohurs, but the latter came to be undervalued, and disappeared from circulation. The recommendations of the Directors in 1806 had allowed discretion to the Indian authorities as regards the time and manner of giving effect to them, and they were not acted upon immediately. In 1818, however, the silver rupee of 180 grains, 11/12th fine, was substituted for the gold pagoda in the Madras Presidency. The coinage of gold pagodas in Madras was stopped, but, for the convenience of the public, it was announced that gold coins would be issued, and would be paid and received by all the

public offices at such rates as might be determined by proclamation from time to time, the first rate chosen being 15 : 1.

In the meanwhile, the Bombay rupee had been made identical with the Madras rupee in 1823, and the last step was taken in 1835, when the Indian rupee in its present form and size was issued, being the same in regard to weight and fineness as the Madras rupee of 1818, and was made sole legal tender of payment throughout the territories of the East India Company. Mints were opened to its free coinage, and the Indian system came to be one of silver monometallism, instead of the bimetallic or parallel standard system which had prevailed so far. The value of the silver bullion in the rupee and its legal value were identical. This Act remained in force up to 1893.

§4. **The second period (1835-74).**—The Act of 1835, however, authorized the coinage of gold mohurs and of five-, ten-, and thirty-rupee gold pieces at market value, if required by the public. In 1841, a proclamation was issued authorizing the public treasuries freely to receive the gold mohurs at their face value, that is to say, at the rate of 15 : 1, in payment of public dues. In 1848 and 1849, owing to the Australian and Californian gold discoveries, the price of gold fell in terms of silver. Gold was overvalued in the official ratio of 15 : 1, and the holders of gold coins availed themselves of the opportunity to obtain a larger price in silver than they could obtain in the market. People began to pay their public dues in the depreciated gold coins rather than in rupees, much to the embarrassment of the Government. Lord Dalhousie's Government, therefore, withdrew the proclamation of 1841, and gold was thus definitely demonetized. These steps led to a great stringency in the money market, which was particularly felt owing to the expansion of trade. After 1850 the production of silver was less than was the demand for it. Also a large proportion of silver rupees were being abstracted from circulation and being put to non-monetary uses. 'The Mint was pitted against the smelting pot, and the coin produced by so much patience and skill by the one was rapidly reduced into bangles by the other.'[1] There were no credit media to speak of to relieve the monetary stringency, and banking was yet in an undeveloped condition. In these circumstances people began to have recourse to their own remedy, as was pointed out by the Bombay Chamber of Commerce in a memorial to the Government of India praying for a gold currency, in which it was said that 'there is an increasing tendency to the creation of a gold ingot currency, by the natives of this country, as a rude remedy for the

[1] Cassels quoted by Ambedkar, *The Problem of the Rupee*, p. 34.

defects of the existing silver one', and 'that gold bars, stamped with the mark of Bombay banks, are for this purpose circulated in several parts of the country'.[1] The American cotton famine brought fancy prices in gold to Indian cotton exporters, and gold was imported on a very large scale. There arose, therefore, a demand supported influentially by the three Chambers of Commerce for the introduction of a gold currency—a demand which was all the stronger, because the fear that had been felt about the depreciation of gold was largely belied by actual experience. In November 1864, therefore, the Government of India issued a notification by which sovereigns and half-sovereigns were to be accepted at Government treasuries at the rate of Rs. 10 and Rs. 5 respectively, and the Government of India were to pay sovereigns and half-sovereigns to their creditors when convenient, and if the latter desired to receive them in payment. In 1866 the Calcutta Chamber of Commerce again urged the adoption of a gold currency, and the Government of India appointed the Mansfield Commission, which was the first of the committees and commissions which have sat from time to time to deliberate upon the problem of Indian currency and have ladled out conflicting panaceas to cure the currency ills of the country. The Mansfield Commission recommended that (i) gold coins of 15, 10, and 5 rupees should be issued, as they were likely to be preferred by the people to notes of like values, and as the introduction of the gold currency would pave the way for the establishment of currency notes; and that (ii) the currency should consist of gold, silver and paper. But, for reasons which have never been clearly explained, no definite action was taken on the Report of the Mansfield Commission. In 1868, a notification was issued by which the rate for the receipt of sovereigns and half-sovereigns was raised from Rs. 10 and Rs. 5 to Rs. 10-8 and Rs. 5-4 respectively, as the former rate was out of harmony with the market rate and failed to attract gold to the public treasuries. In taking these steps, without any explicit reference to the Mansfield Commission, the Government showed their desire ultimately to make gold legal tender, but they wished to make sure of the fact as to the relative value of gold and silver in India before stereotyping the results by law and finally committing themselves to the legal tender of gold. In 1872 Sir Richard Temple submitted a note to the Government of India suggesting that a gold standard and currency was what was really wanted in India, and that a Commission should be appointed to decide definitely what should be the rating of gold and silver. The Council of the Governor-General were, however,

[1] Ambedkar, op. cit., p. 42.

not unanimous, and the second period in the currency history of India came to an end with the decision of the Government of India in 1874 not to accept the proposal.

§5. **The third period (1874-93).**—By 1874 a great change had begun in the monetary status of silver. Germany demonetized silver in 1873. Sweden, Denmark and Norway followed in 1874, closing their mints to the free coinage of silver. The countries of the Latin Union had to fall into line, with the result that huge quantities of silver were thrown on the market. There was also an enormous increase of output of silver from new mines and owing to improved processes. The demand for gold, on the other hand, was increasing owing to its introduction as the only standard in Europe and the United States, and to the general expansion of trade, while the supply was declining. Gold and silver became in their relation to each other simply commodities with no connecting monetary link. The depreciated metal began to flow on a huge scale into silver standard countries, and India more than ever became a sink for silver, which, as it came in, was largely coined into rupees by the Indian mints. This heavy coinage was one of the causes which set up a decided tendency towards a rise of prices in India, though the phenomenon became much more marked after 1900, as we shall see later on. From 58*d.* per ounce in 1875, the price of silver fell to 52½*d.* in 1879; 43*d.* in 1888; 37½*d.* in 1892; and 27*d.* in 1899.

With the depreciation of silver the exchange value of the rupee in terms of the sovereign, that is to say, its gold value, began to move down, and fell from about 2*s.* in 1871, to about 1*s.* 2*d.* in 1892. This is, however, anticipating matters to some extent. By way of picking up the thread of the narrative we have to notice that from 1874 up to 1878, the agitation for reform in India was directed chiefly to the closing down of the mints for the free coinage of silver with a view ultimately to the adoption of the gold standard. In 1876, the Bengal Chamber of Commerce and the Calcutta Trade Association sent a memorial to the Governor-General requesting the temporary suspension of compulsory coinage of silver by the Indian mints. The Government, however, refused to grant this request, being of the opinion that, without the substitution of gold as a standard, no such step was possible, and that they were not able to adopt the gold standard under the prevailing circumstances, which were still unsettled; and lastly, that the uncertainty in the situation was caused not only by the depreciation of silver but also by the appreciation of gold. In 1878, however, the Government of India themselves proposed to the Secretary of State that definite steps should be taken in the direction of a gold standard with a gold

currency, and that, in the meanwhile, the cost of the rupee should be increased to the public in India by charging an additional seigniorage in order to establish a definite relation between the gold coins and the rupee, which might, if necessary, be altered from time to time. The Secretary of State referred this proposal to a Committee, which opposed the scheme on various grounds, and advised, with a somewhat pontifical air, that 'it was better to sit still than to have recourse, under the influence of panic, to crude legislation the result of which cannot be foretold and the effect of which cannot be measured'. As an alternative to a gold standard, the Government of India pathetically clung for a long time to international bimetallism, with a devotion worthy of a Mrs Micawber, when practically every other nation was deserting it. Between 1867 and 1899, there were no less than four International Monetary Conferences held to propose remedies for the currency difficulties in the different European countries and the United States. India was throughout inclined in favour of international bimetallism mainly because of her faith in its special use for herself as a means of rehabilitating silver in the currencies of the world, which, she hoped, would raise the price of silver and thus extricate her from her exchange difficulties. But the scheme fell through chiefly because of the opposition of England and the general desire on the part of the other European nations to adopt the gold standard in imitation of England, which led them to take up an attitude of hostility to the introduction of bimetallism in the silver-using countries. They feared that the demand for gold which this would cause on the part of the silver-using countries would raise the price of gold to inconvenient heights and embarrass the countries of Europe, which were intent upon the establishment of the currencies on a stable gold monometallic basis.

§6. **The fourth period (1893-1900).**—In the meanwhile, the continued fall in the value of silver and the decision of the United States to repeal the Sherman Act, under which that Government was required to purchase 54 million ounces of silver for annual coinage, made the position of silver and therefore the position of the Indian rupee more precarious than ever. In these circumstances, the Government of India again approached the Secretary of State in 1892 with the proposal to close the Indian mints to the free coinage of silver with the object of eventually introducing the gold standard, if the International Monetary Conference then sitting at Brussels failed to arrive at any conclusion in favour of international action. Accordingly, in 1892, the Herschell Committee was appointed to consider the currency and exchange situation with special reference to the above proposal of the Government of India.

While the Herschell Committee was still sitting, the Brussels Conference ended in a fiasco. The Herschell Committee had to suggest a remedy for the following principal defects of the Indian currency system as it then existed: (i) the financial difficulties of the Government of India caused by silver monometallism and the falling rates of exchange with the gold standard countries; (ii) the evil effects of the fall in exchange on the people of India and her commerce; (iii) the difficulties caused by the fall in exchange to European officials in India.

§7. **(i) The financial difficulties of the Government of India.**[1]— The difficulties of the Government came principally from the fact that they had to remit yearly a very large sum to England in discharge of their gold obligations, viz. the Home Charges. The gold value of the rupee determined the actual incidence of this charge in India and, as we have seen, this value had been constantly falling ever since 1874, and there was every prospect of its further fall. The inconvenience to the Government of this state of affairs was well described by Sir David Barbour, the Finance Member of the Governor-General's Council from 1888 to 1893, as follows: 'The immediate cause of our financial difficulties, and the cause which, by comparison and for the time being, dwarfs all others, is the fall in the gold value of silver, which has added to the Indian expenditure in two years more than four crores of rupees. If that fall could be stayed and the rate of exchange with England fixed permanently at even its present low figure, the difficulty of dealing with the present deficit would be comparatively light. . . . Our financial position for the coming year is at the mercy of the exchange, and of those who have it in their power to affect in any way the price of silver. If we budget for the present deficit of Rs. 15,95,100 and exchange rises one penny, we shall have a surplus; if it falls a penny, we shall have a deficit of more than three crores; if we impose taxation to the extent of one and a half crores of rupees, a turn of the wheel may require us to impose further taxation of not less magnitude; another turn, and we may find that no taxation at all was required.'

§8. **(ii) Effect of fall in exchange on the people of India.**[2]— The increased number of rupees which the Government were required to find for meeting their sterling obligations meant more taxation in terms of rupees. This of course did not necessarily involve a permanent increase of the burden of taxation, for in course of time adjustment would have taken place by a rise in silver prices in

[1] See *Herschell Committee Report*, pars. 3-6.
[2] ibid., pars. 32-4.

India, so that a larger number of rupees would have meant the same quantity of produce, and it is the quantity of produce and not the number of tokens representing it, that is the proper measure of the burden. A certain time, however, must elapse before the adjustment is completed, and in the meanwhile the Indian ryot would have to pay more in terms of produce. The Herschell Committee proceeded to point out that although the burden upon the people as a whole might not eventually be greater on account of the fall in exchange, there was likely to be a transfer of burdens from one class to another. Owing to the fall in exchange, the burden of those who paid a fixed land revenue under a permanent settlement had been lightened, and so had the burden of those whose land revenue had not been recently resettled. On the other hand, the increased salt tax pressed upon the people at large, and rendered more heavy the taxation of those who had suffered from the higher rupee prices due to the fall in the gold value of silver.

Those in favour of the continuance of the silver standard argued that the fall in exchange acted as a stimulus to exports, and that, although in theory it was unfavourable to imports, in actual fact India's import trade had not suffered. For the gold prices of these imports had fallen and were declining more rapidly than the gold value of the rupee, so that India was certainly not receiving from Europe smaller quantities of the goods she imported, on the average per rupee as well as per sovereign, than she did in 1872-3. As Kemmerer points out, 'the actual development of the merchandise import and export trade during the twenty years prior to the Herschell Committee Report had hardly been such as to justify a strong condemnation of the silver standard'.[1]

Now as regards the stimulus to exports, this is clearly a transient benefit, as the exchange could not be expected to keep on descending indefinitely. Moreover, as against the stimulus to exports we must put the discouragement to imports. It may be that, owing to the fall in gold prices of imports, India was receiving as much of these imports as before the fall in exchange set in. But if the Indian exchange had not been declining and at the same time the gold prices were falling, India would have received even larger quantities of produce than she actually did. Leaving out of account temporary gains and losses to exports and imports respectively, another important argument against letting things alone was that about 74 per cent of the total imports of India came from gold-using countries, while 26 per cent only came from silver-using countries. Intimate financial and commercial relations had thus

[1] E. W. Kemmerer, *Modern Currency Reforms*, pp. 27-8.

been established with gold standard countries, and a constant fall in the value of the rupee must of necessity seriously embarrass India's foreign trade and have the result of introducing an unhealthy element of speculation into it. Further, even if the falling rupee conferred a temporary benefit on the employer in India, this was at the expense of the wage-earner, because wages rise more slowly than prices. Thus, considering the benefit to India as a whole, it could not be said that a continuous fall in exchange was an advantage.

In view of the difficulties caused both to Government finance and to the commercial community, it would be difficult to find much fault with the Government's anxiety to give up the silver standard in favour of the gold standard. The alternative method of increasing taxation, especially taxation in the form in which it would not have been unpopular, namely, by means of import duties, and of severe retrenchment in public expenditure, was no doubt not absolutely impossible. But given the prospect of constant fluctuations in the value of the rupee, continuous resort to taxation and economy would have been extraordinarily difficult and unsettling in its effect. We repeat, therefore, that the Government's desire to end all this uncertainty by switching the currency on to gold was natural and even commendable.

§9. **Fall of exchange and foreign capital.**—The influence of a heavy fall in exchange was tending greatly to check the investment of British capital in India and the development of the country, which largely depended upon such investment. For, 'London is the lending market, and London thinks in gold'. The uncertainty as regards the interest on the investment and the prospect of the diminution which the invested capital might suffer, if it were desired to retransfer it to England, impeded the flow of British capital into India. Foreign firms were also finding a difficulty, owing to the falling exchange, in procuring the services of European servants, required for conducting their undertakings in India. The difficulty in attracting foreign capital to the country also had a prejudicial reaction on the finances of local bodies in India.

§10. **(iii) Position of European officials.**—The Indian Government were also faced with difficulties as regards their own officers, who began to put forward claims for compensation for the loss which they sustained owing to the fall in exchange. They received their salaries in rupees, and to remit a given amount in terms of sterling to England for the support of their families and the education of their children, they had to spend a larger and larger portion of their income than before. This had led to serious discontent amongst them.

§11. **Recommendations of the Herschell Committee.**—Having convinced themselves that the existing monetary system was in urgent need of reform, the Herschell Committee proceeded to suggest remedies. Bimetallism was now out of the question. But instead of demonetization of silver and the establishment of a gold standard currency, a sort of limping standard was recommended, under which there was to be no free mintage either of gold or of silver, and the rupee was to continue to be unlimited legal tender, gold being used only partially for currency purposes during the period of transition, at the end of which further steps were to be taken to introduce a full-fledged gold standard.

§12. **The Government's action on the Report.**—The Government of India approved of the Report, and in 1893 an Act was passed to amend the Coinage Act of 1870, and the Indian Paper Currency Act of 1882. It provided for the immediate closure of the Indian mints to the free coinage of silver, though the Indian Government were allowed to retain power to coin rupees on their own account. There were also three administrative Notifications issued at the same time. The first provided for giving rupees in exchange for gold coin and bullion presented at the Indian mints, at the rate of 16*d*. to the rupee. The second Notification authorized the reciept of gold sovereigns and half-sovereigns in payment of public dues at the same rate. By the third Notification provision was made for currency notes being issued from the Paper Currency Offices, in exchange for gold coin or bullion, at the same rate.

The object of these provisions was, first, to force up the exchange value of the rupee, or rather to arrest its further fall; secondly, to encourage the import of foreign capital; thirdly, to familiarize the people with the use of the gold sovereign; and lastly, to discourage the import of silver. The general idea was to take the first steps towards the eventual introduction of the gold standard, and to link India with gold-standard countries immediately. It was thought that a period of transition was necessary before the actual establishment of the gold standard.

§13. **Circumstances leading to the appointment of the Fowler Committee (1898).**—The currency position from 1893 onwards was avowedly transitional and provisional, and some definite action still remained to be taken. This was hastened by the representations of the commercial community, who were inconvenienced by the famishing of the money market through the closing of the mints and the temporary suspension of the sale of Council Bills, resulting in very high rates of discount. In the meanwhile, the rupee had been gradually gaining in exchange value, and the time seemed to have arrived to place India definitely on a gold basis, or at least, to take

a few further steps forward in that direction. This led to the appointment of the Fowler Committee in 1898.

§ 14. **The Government of India's proposal.**—The Committee considered several proposals. The first was that of the Government of India, which contemplated a further contraction in the volume of rupees so as to raise the value of the coin to *1s. 4d.* By 1898 the Government of India had come to the conclusion that silver should be definitely demonetized, and that steps should be taken with a view to the ultimate introduction of a gold standard. The experiment of closing the mints for silver appeared to have been highly successful from their point of view, as the rupee had steadily mounted up in exchange value since then, as the following statement shows:

Calendar year	Intrinsic value of rupee as silver bullion	Average exchange value of rupee
		s. *d.*
1894	11 1 3*d.*	1 1 1/2
1895	11 3/8*d.*	1 1 3/8
1896	11 7/8*d.*	1 2 1/2
1897	10 1/2*d.*	1 3 1/4
1898	10 3/8*d.*	1 3 7/8

The Government of India made the following proposal as a first step towards the establishment of a gold standard:

(i) Money should be borrowed in England and part of it should be remitted to India in the form of gold to serve as the nucleus of a gold reserve. (ii) A certain number of rupees should be withdrawn from circulation and melted down in order to raise the gold value of the rupee to *1s. 4d.*[1] (iii) The silver bullion obtained by melting down the rupees should be sold for gold which was to be added to the reserve. (iv) The Government should not part with any of the gold in their possession until the exchange value of the

[1] This showed the Government's implicit faith in the quantity theory of money. But Nogaro points out that the simple relation required by the theory between the rise of the rupee and the limitation of its quantity did not, as a matter of fact, exist. For the rise in exchange did not come about in the expected manner of, first, a fall in internal prices, and then diminished imports and increased exports leading to a favourable exchange. In fact, Indian prices remained steady for nearly five years after the closing of the mints, between 1893 and 1897, and there was actually a sharp rise of prices in 1898. It is also significant that exchange stability was achieved in 1900 just when the Government had started minting rupees on a large scale. The real cause that sent up the exchange value of the rupee was the snapping of the link between the rupee coin and the metal silver of which it was made, making it possible for the former to rise in value while the latter was depreciating. In taking the measures they took, the Government thus builded better than they knew from the point of view of gaining their object. See Bertrand Nogaro, *La Monnaie,* pp. 48-54, and V. G. Kale, *Indian Economics*, vol. II, p. 439 n.

rupee had risen to 1*s.* 4*d.* Till then gold was not to be made legal tender in India, though this was to be the future goal of currency policy.

This proposal was founded on the belief that the contraction of currency relatively to the demand for it, due to the closure of the Indian mints, had been the real cause of the rise in the exchange value of the rupee, and that, so long as this cause continued to operate, a further rise in the exchange value might be expected, until eventually the rate of 1*s.* 4*d.* was established. The Fowler Committee were unable to agree with the view that 'the rise in the exchange value of the rupee was entirely due to the contraction of currency', and held that 'the forces which affect the gold value of the rupee are complicated and obscure in their operation'. They were therefore not prepared to recommend the drastic action proposed by the Government of India, especially as they feared that such action would accentuate the stringency in the Indian money market and would provoke the opposition of the commerical classes.

§15. **The Lindsay scheme.**—Among the other proposals before the Committee special mention must be made of the scheme put forward by A. M. Lindsay, Deputy Secretary and Treasurer of the Bank of Bengal. The importance of this scheme is due to its close resemblance to the plan which was in fact introduced later on. It suggested the raising in London of a long-period loan of £10 millions to be kept there as the Gold Standard Reserve. The arrangement of 1893 was intended to prevent the rise of the rupee above 1*s.* 4*d.* by making it binding on the Government to give rupees in exchange for gold or gold sovereigns. Lindsay's aim was to supplement this plan by making arrangements to give sterling in exchange for rupees so as to prevent the fall of the rupee below 1*s.* 4*d.* It was therefore proposed that the Government of India should sell in India sterling drafts on London for not less than £1,000 at the rate of 1*s.* 3¾*d.* per rupee, which were to be met from the reserve in London.

In London, rupee drafts were to be sold to applicants for not less than Rs. 15,000 at the rate of 1*s.* 4 1/16*d.* per rupee, and these were to be met at Calcutta and Bombay. If an excess of rupees accumulated in India as the result of selling sterling drafts, and consequently the reserve in London was unduly depleted, the excess of rupees was to be sold as bullion and the proceeds credited to the reserve in London. If, however, the stock of rupees in India was inadequate, silver was to be purchased out of the gold reserve in London and sent to India to be coined into rupees. The essence of this plan was that the rupee was to be the circulating medium in India, and gold was not to be legal tender. The Fowler Committee

turned down the scheme, as they feared that its adoption would check that flow of capital to India upon which her economic prosperity so largely depended, and they objected that, if the system was made permanent in India, it would base India's gold standard for all time on a few millions of gold in London, with a liability to pay in terms of gold in London for rupees received in India to an indefinite extent.

§16. **Back to silver.**—Another proposal before the Committee was a return to silver monometallism. The question of closing the mints for silver had formed the subject of heated debate for a long time before the step was actually taken and had evoked strong opposition from official and non-official quarters. For example, R. Hardy, Treasurer and Secretary of the Bank of Bengal, argued as follows in a memorandum which he submitted in 1886: 'The foreign trade of India consists of exports of merchandise; the exports pay, not only for India's gold obligations abroad, but for her imports of merchandise as well, and a balance always remains in her favour. This balance she takes in silver. If silver is cheap she gets more of the metal than she would get if it were not so cheap, and I hold that it is most to her advantage to get more rather than less silver. The pressure of the gold payments upon India as a whole depends not upon the price of silver but upon the gold prices realized for the merchandise exported to meet such gold payments. That the Government is in the position of receiving its revenue in silver, it may be asserted, does not affect that, the national aspect of the question, and it is therefore clearly the duty of Government to meet any financial necessity arising from a fall in the exchange, either by increasing taxation or by reducing expenditure, or by both. To attempt to meet the difficulty by taking the extreme measure of changing the standard of value is, I think, out of the question, and I express this view, holding the opinion that the value of silver will probably yet fall considerably.'

Similarly, J. Westland, the Controller and Auditor-General, wrote in 1886: 'I am inclined rather to say that greater facility in meeting its home obligations is the only interest that India has in a gold standard; and if a silver standard is better with respect to all its other relations and concerns, I cannot concede that the question connected with its home obligations is of such tremendous importance as to overwhelm all others. The fact that our European officials, regarding our connexion with India as only temporary, look to the gold standard of the country, where we ultimately intend to live, as preferable for our own purposes, to the silver standard of the country where we earn our living, is somewhat apt to increase in our eyes the importance of remittance from India to England.

But if we wanted to stay in India all our lives, and our children after us, as the definite majority of people dwelling in India do, I doubt if we would look upon a manifestly appreciating standard as more desirable than one which has been fairly steady in the past, so far as absolute value can be measured.'

Mr David Barbour, when he was Secretary to the Government of India in the Department of Finance and Commerce, was amongst the strongest opponents of a gold standard for India, and held that, 'the loss or gain to India as distinguished from the Government of India, in respect of her permanent gold obligations depends entirely on the gold prices which she can obtain from her exports. No manipulation of the Indian currency can possibly affect the gold prices of Indian exports and give any relief to India as a country, whatever effect it might have on the financial position of Government. Just as much as Government gained, just so much must the Indian people lose '.[1]

By 1893, however, the opposition to the closing of the mints to silver had abated considerably, and it is significant that Barbour, who had some years ago vigorously opposed the plan, was himself the Finance Member, and as such sponsored the change of 1893. He had been of opinion that the salvation of India lay in international bimetallism. When, however, he found that that idea was impossible of accomplishment he transferred his allegiance to the gold standard. And when five years later it fell to the Fowler Committee formally to consider the question of re-opening the mints, it found that there were comparatively few advocates of the silver standard left. Even Sir James Westland, whose opinion against the abandonment of the silver standard has been quoted above, opposed its restoration in 1898 in his capacity of Finance Member to the Government of India. He now regarded the demonetization of silver as an accomplished fact and stuck to an honest interpretation of the gold standard as implying the closure of the mints for the coinage of silver not only for the public but also for the Government itself. This is what he said in 1898, when a demand was made by some people that the Government should resume the coinage of rupees for relieving monetary stringency: 'In our opinion, the silver standard is now a question of the past. It is a case of *vestigia nulla retrorsum.* The only question before us is how best to attain the gold standard. We cannot go back to the position of the open mints. There are only two ways in which we can go back to that position. We can either open the mints to the public generally or we can open them to coinage by ourselves. In

[1] All these three extracts are quoted by Kale, op. cit. (seventh edition), vol. II, pp. 498-9.

either case, what it means is that the value of the rupee will go down to something approaching the value of silver. If the case is that of opening the mints to the public the descent of the rupee will be rapid. If it is that of opening only to coinage by the Government, the descent of the rupee may be slow but it will be no less inevitable.'

§17. **Recommendations of the Fowler Committee.**—The Fowler Committee had thus not much difficulty in rejecting the plea for the restoration of the silver standard, as no fresh arguments had been brought forward, and the actual discontinuance of the silver standard since 1893 had sensibly weakened the case for it. It concluded that the ideal to be aimed at was the 'effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold', and with this end in view made the following proposals: (i) The Indian mints should be thrown open to the coinage of gold sovereigns and half-sovereigns on terms and conditions such as governed the three Australian branches of the Royal Mint. The mints should remain closed to the free coinage of silver as already decided in 1893, 'until the proportion of the gold in the currency is found to exceed the requirements of the public'. (ii) The exchange rate was to be finally fixed at 1*s*. 4*d*. per rupee, as this was the rate that had already been established, and, prices having been adjusted to it, it would be easier to maintain than any other ratio. (iii) The rupee might continue to be unlimited legal tender, for, so long as the principle of limitation was in effective operation, and no fresh rupees were coined, the value of the rupee would be maintained at the ratio decided upon, and it was not necessary to make it also limited legal tender for this purpose. (iv) The Government should continue to give rupees in exchange for gold, though they should not bind themselves to give gold in exchange for rupees, because the undertaking of such an obligation would be inconvenient and make them liable to sudden demands for gold, to meet which it might sometimes be necessary to raise sterling loans at a heavy cost. (v) To secure the convertibility of the rupees into sovereigns, the profits on any future silver coinage undertaken by the Government should be credited to a gold fund to be kept 'as a special reserve, entirely apart from the Paper Currency Reserve and the ordinary treasury balances'. For although no legal obligation to convert rupees into gold was to be imposed on the Government, it would be an advantage if they could pay out gold when their reserves permitted and the people were willing to accept it. (vi) The Government should be prepared to make gold available, particularly for export when the balance of trade went against India. The Committee expected this gold to come from the gold reserves generally and especially from the gold fund proposed

by it, but eventually also from circulation, which would become saturated with a large amount of gold as the result of the full introduction of a gold standard and gold currency.

In short, the Fowler Committee held that a fixed exchange could only be secured and guaranteed by an effective gold standard. The Committee accepted as their model the limping standard adopted by the Latin Union and the United States, under which both gold and silver were unlimited legal tender with a fixed legal ratio, and mints were open only to the free coinage of gold. The recommendations of the Fowler Committee were accepted almost entirely by the Government of India, and the Act of the year 1899 made sovereigns and half-sovereigns legal tender throughout India at the ratio recommended by the Fowler Committee.

Negotiations were also set on foot for starting a gold mint in India, but they proved abortive on account of the opposition of the British Treasury.

A Gold Standard Reserve was formed in 1900 out of the profits of the coinage of rupees on Government account, which was resumed for the first time after 1893.

§18. **Remedies adopted in relief of monetary stringency.**—(i) *Circulation of gold.*—After the above action had been taken in faithful compliance with the Fowler Committee's recommendations, Government policy soon broke loose from its moorings and drifted aimlessly until it landed into the patchwork of improvizations called the Gold Exchange Standard. The Fowler Committee had recommended that fresh coinage of rupees should not be undertaken until the proportion of the gold in the currency was found to exceed the requirements of the public. The Government, however, were forced to resume coinage under the pressure of a number of circumstances. The closing of the mints had resulted in a stringency which was felt keenly as trade expanded and population increased. As a temporary measure for meeting the situation, Act II of 1898 had already been passed, by which 'the proceeds of the Secretary of State's sales of Council Bills could be set aside at the Bank of England in gold as part of the Indian Paper Currency Reserve. The Government of India could issue notes against the gold so set aside, and with them could meet *pro tanto* the Secretary of State's drafts, without reducing their treasury balances'.[1] This

[1] As Kemmerer points out, this measure was practically an adoption of the Lindsay Plan by the Government (only however to reject it a year afterwards on the recommendation of the Fowler Committee). For it meant 'the sale of exchange in London by the Secretary of State on the Paper Currency Reserve in India, [at rates representing practically the gold-export point for London, with the primary object of realizing currency to meet monetary demands in India]'. Kemmerer, op. cit., p. 102.

had the effect of adding to the drain on the stock of rupees with the Government of India. In order both to familiarize the people with gold coin and to obviate the necessity of fresh coinage of rupees, the Government made an active attempt in 1899 and 1900 to introduce sovereigns into circulation by instructing post offices, paper currency offices, district treasuries and railways to encourage receipts and payments in the form of gold coin. Many of the gold coins thus issued, however, were soon returned to the Government, who regarded this as a failure of the experiment to induce people to use sovereigns as the medium of exchange. The Government, however, seem to have admitted defeat too soon and too readily, and even among their own officials there were not wanting some who saw no reason to be dissatisfied with the actual results of the experiment. Sir C. E. Dawkins remarked in the course of his Financial Statement for 1900-1; 'I believe that the rate at which gold is taken is likely to increase slowly, and that gold will pass gradually into general circulation in our seaports and large towns. No expectation was ever formed, nor is there any reason to desire, that gold would penetrate into the interior, or that the large mass of transactions in the country would ever be conducted except through the medium of silver and copper. Gold is behaving very much as we anticipated.' Dr Cannan also regards the alleged dislike for gold on the part of the Indian people as a myth. The allegation, he says, 'is suspiciously like the old allegation that the Englishman prefers gold coins to paper, which had no other foundation than the fact that the law prohibited the issue of notes for less than £5 in England and Wales, while in Scotland, Ireland, and almost all other English-speaking countries notes for £1 or less were allowed and circulated freely. It seems much more likely that silver owes its position in India to the decision which the Company made before the system of standard gold and token silver was accidentally evolved in 1816 in England, and long before it was understood; and that the position has been maintained, not because Indians dislike gold, but because Europeans like it so well that they cannot bear to part with any of it'.[1]

The experiment was not only not persisted in sufficiently long, but the circumstances in which it was launched were also exceptionally unpropitious, because the famine conditions which prevailed intensified the demand for rupees. Sir Edward Law, the Finance Member, explained the phenomenon thus: 'The great bulk of the population is purely agricultural. The agriculturist, in ordinary times, has little requirement for money in the shape of silver coin;

[1] Dr Cannan's Foreword to Ambedkar, *The Problem of the Rupee*, p. xiii.

he is himself the producer of a large proportion of the food he consumes, and his other wants which must be satisfied by purchase are trifling. In seasons of famine, however, the situation is changed. The food consumed by the suffering agriculturists must be purchased and paid for with coin, and, as credit dries up in times of distress, all his other requirements must equally be paid for in cash.' R. G. Hawtrey, criticizing this view, remarks that Sir Edward Law's explanation of the intensified demand for rupees in 1899-1900 'was no more than an ingenious conjecture '.[1] According to him the demand occurred at a period of good trade. He admits it as a most striking fact that the period of rising exchange from 1896 to 1900 was marked by two severe famines, one in 1896-7 and the other in 1899-1900, and that this gave a certain plausibility to the theory put forward by Sir Edward Law. All the same he rejects the theory and argues that there may be more cash transactions in a time of famine than in a time of plenty, but that does not mean that people will hold larger cash balances.

(ii) *Issue of notes and rupees.*—However that may be, the Government felt themselves forced to resume coinage on a large scale in 1900. The silver required for this purpose was purchased with the gold in the Paper Currency Reserve in London. We have already referred before to Act II of 1898 by which the receipts from the sales of the Secretary of State's Council Bills were set apart in the Paper Currency Chest, and notes were issued in India against them. This was intended to be a purely temporary arrangement, and the Act provided that the gold so set apart was to be held by the Secretary of State in London, 'until he shall transmit the same in gold coin or gold bullion to India, or until the Government of India shall appropriate and set apart in India as a part of the Currency Reserve an amount of coin of the Government of India equal in value to such notes'. This Act was extended in the first instance to two and a half years, and again by two years more in 1900, when the Secretary of State was authorized to use the gold so received by him for the purchase of silver bullion to be sent to India to be coined into rupees, and to treat such bullion in transit and in process of coinage as part of the Paper Currency Reserve. The Reserve in London was thus made to serve three distinct purposes. (*a*) It provided funds in London for the purchase of silver for coinage whenever necessary. (*b*) It could be used to support the Indian exchange, whenever India had an unfavourable balance of trade and it was impossible or disadvantageous to sell Council Bills. The Secretary of State would, in these circumstances,

[1] R. G. Hawtrey, *Currency and Credit*, pp. 345-7.

use the gold in the Paper Currency Reserve to meet his expenses and an equivalent amount would be transferred to the Paper Currency Reserve in India.[1] (*c*) And lastly, it was a fund into which payments might be made by the Secretary of State whenever he sold Council Bills in excess of his requirements in order to prevent exchange from rising unduly high and inducing an undesirable shipment of gold to India. Against these payments notes would be issued in India.

In 1902 these provisions were made permanent. In 1905, £5 millions, that had accumulated in the Reserve in India, were shipped to London to be held in the Paper Currency Chest of ear-marked gold (not to be used for ordinary expenses) at the Bank of England, and a stated part of the Currency Reserve was invested in sterling securities. Since 1906 a substantial part of the Paper Currency Reserve came to be maintained in the form of gold.

§19. **The Gold Standard Reserve.**—In the year 1900, the Government of India proposed the constitution of a Gold Reserve to be kept in India as desired by the Fowler Committee. They proposed further that the Paper Currency Reserve should gradually revert to its original position and should be used only for the encashment of currency notes and further that it should consist principally of rupees and securities. The Gold Reserve, on the other hand, should consist chiefly of gold. The Secretary of State, however, decided against this. He preferred to have the gold located in London and invested in sterling securities. He held that, since London was the place in which the Reserve would have to be applied on the occasion of the emergency against which it was being created, London would be the best place in which to keep it. In this manner, instead of being used primarily as a gold redemption fund and for the maintenance of the exchange parity of the rupee, the Gold Reserve came to be regarded merely as part of the total surplus Government funds and as a kind of 'secondary reserve'. The work of maintaining the parity of the rupee fell chiefly on the Paper Currency Reserve and the sale of Council Bills in London, 'with the result that the three funds, namely, the Paper Currency Reserve, the Gold Reserve, and the Secretary of State's balances, soon found their functions confused, the properly fiscal function of the last fund and the properly monetary function of the other two being sadly mixed'.

According to the plan insisted upon by the Secretary of State,[2] the profits from the coinage of rupees were remitted to London for

[1] See §20.

[2] The account that follows is based mainly on the *Chamberlain Commission Report*.

investment, and this was effected by gold being withdrawn from the Paper Currency Reserve in London in exchange for the fresh rupees coined in India. In 1906 the difficulty in meeting the demand for rupees led to the formation in India of a special Rupee Reserve outside the Paper Currency Reserve, called the Silver Branch of the Gold Standard Reserve.[1] The Rupee Reserve was intended to prevent the exchange from rising above 1*s.* 4*d.*, which necessitated the keeping open of an unlimited offer of rupees in exchange for sovereigns at this rate in India. The Notification of 1893 which had authorized the issue of rupees or notes against the tender of gold as distinguished from the British gold coin was withdrawn. In the meanwhile, the practice of shipping to London gold accumulated in the various reserves in India was found to be needlessly expensive, and, therefore, the practice of selling Council Drafts was extended beyond its original purpose after the year 1904, when the Secretary of State announced his intention of offering Council Bills for sale without limit of amount at the price of 1*s.* 4⅛*d.* If the cash balances in India were inadequate for this purpose, the demand was to be met by withdrawing rupees from the Paper Currency Reserve in India, an equivalent amount of gold being credited to the paper Currency Chest in London. The price of 1*s.* 4⅛*d.* not being found prohibitive at all times of the export of sovereigns to India, which accumulated with the Indian Government, it was decided to offer Telegraphic Transfers against sovereigns in transit from Egypt and Australia to India, the rate for the Transfers being between 1*s.* 4*d.* and 1*s.* 4 1/32*d.* (that is, lower than that for the Council Bills),[2] so as to make it worth the while of the owner of such sovereigns to divert them from India to London.

In June 1907, the Mackay Committee on Indian Railway Finance recommended that one million sovereigns out of the profits on the coinage of rupees in 1907 should be spent on railways. The Secretary of State went beyond the Committee and decided to spend on railways in the future one-half of any profit on the coinage of rupees, until the Gold Standard Reserve reached £20 millions, apparently contemplating the diversion of the whole of the profits to the railways after the maximum had been reached. The Government of India telegraphed to the Secretary of State that the portion of the Gold Standard Reserve in the form of sterling securities should be allowed to accumulate up to £20 millions before any such diversion was effected. The Secretary of State, disapproving,

[1] The Gold Reserve came to be known as the Gold Standard Reserve from this date.

[2] For a detailed explanation of the working of this system see Keynes, *Indian Currency and Finance*, pp. 114-18.

adhered to his decision, which, however, he had to reverse completely in 1909, owing to the exchange crisis of 1907-8.

20. **The crisis of 1907-8.**—On account of a partial failure of crops in some parts and the outbreak of actual famine in others, Indian exports declined. In Europe also, after a period of prosperity, which reached its culmination in 1907, a decline set in, leading to unemployment and slack business. The purchasing capacity of Europe was thus impaired and the situation was aggravated by the general monetary stringency caused by a financial crisis in New York. While Indian exports of jute, wheat, cotton, etc., fell off, the imports rose, at least in the case of one commodity, namely silver, owing to a heavy fall in its price. All these factors contributed to the weakening of the Indian exchange. The stock of sovereigns began to diminish rapidly, and the Exchange Banks urged the sale of Telegraphic Transfers on London. This was refused by the Government, who, however, gave gold on certain conditions (not more than £10,000 to any one individual on any one day) from the Paper Currency Reserve. The situation growing worse, the Secretary of State advised the Government to offer Telegraphic Transfers or Reverse Councils on London at the rate of 1*s*. 3 29/32*d*. per rupee, and himself released gold from the Paper Currency Reserve in London, against a transfer of rupees to it from the treasuries in India. He had also to float a sterling loan of £4½ millions to keep up his finances, as no Council Bills could then be sold. He met the demand for the encashment of the Reverse Councils by selling the sterling securities in the Gold Standard Reserve in the market, even although they had depreciated in value. These measures brought about an improvement, and next year exchange was steady at 1*s*. 4*d*., the revival of the export trade from India coming to the rescue.

§21. **Gold Standard or Gold Exchange Standard?**—In meeting the crisis the Government had taken certain steps in a somewhat subconscious and tentative manner in the direction of the Gold Exchange Standard. Gold was at first given freely in exchange for rupees for internal use, whereas there was considerable reluctance displayed in providing gold for private export abroad. This showed that the Government had not yet clearly thought out and definitely adopted the Gold Exchange Standard system. But the subsequent sale of Reverse Councils established a precedent, which brought the Indian currency system appreciably nearer the Lindsay Plan. The practice of paying out rupees and notes in India against deposits of gold in the Paper Currency Reserve in London had already been in vogue for some time, and in 1904 the Secretary of State had declared his willingness to keep the tap turned on indefinitely and

sell the Council Bills to an unlimited amount at a fixed rate. In 1907-8 the sale of Reverse Councils, providing for the conversion of rupees into sterling for international purposes, may be said to have put the coping-stone to the edifice of the Gold Exchange Standard.

All the same, however, the Government of India had not yet formally accepted the whole gospel of the Gold Exchange Standard, and for some time after the crisis of 1907-8, we find them occupied in putting forward proposals which diverged in important particulars from the Gold Exchange Standard system as it came to be established eventually. For example, they had not yet reconciled themselves completely to the location of the Gold Reserve in London and had not quite made up their mind about preventing the circulation of gold as a currency medium in India.

The steps taken in order to meet the crisis had resulted in a serious depletion of the Government's gold resources. In London, the sovereigns in the Currency Chest were reduced from £7 millions to £1½ millions, while in India the whole stock of gold was exhausted.[1] The Government were thus impressed with the necessity of enlarging the Gold Reserve so as to enable them to meet such crises with greater equanimity in the future. In 1909, they proposed to the Secretary of State that £25 millions should be regarded as the minimum necessary for safety, and that, until this figure was reached, no portion of it should be diverted for capital expenditure on railways. They also recommended that the Gold Standard Reserve should be maintained in a more liquid form.

The Secretary of State replied that £25 millions both in the Gold Standard Reserve and the Paper Currency Reserve together would, in his judgement, be the proper standard, and that so long as this combined total was not reached, no diversions would be made from the Gold Standard Reserve, and that the question might be reconsidered thereafter.

He did not wholly agree to the other proposal about maintaining the Reserve in a liquid form, but decided to keep £1 million of the Gold Standard Reserve liquid by allowing this amount to be lent for short periods on approved securities to approved borrowers in London, and to invest the rest in high-class securities with a near date of redemption, or in Consols and other approved stock.

In 1912, in deference to the wishes of the Government of India and in view of public criticism in India, the Secretary of State decided that £25 millions should be the standard for the Gold

[1] See H. F. Howard, *India and the Gold Standard*, p. 35.

Standard Reserve, and that £5 millions in gold should be earmarked as deposit in the Bank of England.[1]

In taking the various steps described above, the Government had almost in spite of themselves steadily deviated from the strait and narrow path of the gold standard recommended by the Fowler Committee, and by a succession of opportunist measures were finally led into the scheme propounded by Lindsay. The system as it developed had not been thought of in 1893 and was opposed by both the Government and the Fowler Committee in 1899, nor is it possible to point to any single date at which it may be said to have been deliberately adopted.

Proposals for gold coinage and a gold mint were revived at the instance of Sir Vithaldas Thackersey, who moved a resolution to that effect in 1912 in the Imperial Legislative Council. Negotiations in this connexion lasted for about a year, when it was decided to refer this question along with others to a Currency Commission which was contemplated.

§22. **The mechanism of the Gold Exchange Standard.**—Mr J. M. Keynes, one of the ablest exponents of the system, the evolution of which has been traced above, and which remained in full operation from 1898-9 to 1915-16, summarizes and explains its main features as follows: '(1) The rupee is unlimited legal tender and, so far as the law provides, inconvertible. (2) The sovereign is unlimited legal tender at £1 to 15 rupees and is convertible at this rate, so long as the Notification issued in 1893 is not withdrawn, i.e. the Government can be required to give 15 rupees in exchange for £1. (3) As a matter of administrative practice, the Government are, as a rule, willing to give sovereigns for rupees at this rate; but the practice is sometimes suspended and large quantities of gold cannot always be obtained in India by tendering rupees. (4) As a matter of administrative practice, the Government will sell in Calcutta, in return for rupees tendered there, bills payable in London at a rate not more unfavourable than 1*s*. 3 29/32*d*. per rupee.

'The fourth of these provisions is the vital one for supporting the sterling value of the rupee; and although the Government have given no binding undertaking to maintain it, a failure to do so might fairly be held to involve an utter breakdown of their system.

'Thus the second provision prevents the sterling value of the rupee from rising above 1*s*. 4*d*. by more than the cost of remitting sovereigns to India, and the fourth provision prevents it from falling below 1*s*. 3 29/32*d*. This means in practice that the extreme limits

[1] See Findlay Shirras, op. cit., p. 215.

of variation of the sterling value of the rupee are 1*s*. 4⅛*d*. and 1*s*. 3 29/32*d*.'[1]

It has been claimed for the Gold Exchange Standard that, while it is much cheaper than a gold standard and a gold currency, it ensures all the advantages of the latter. In India it is obvious that the principal object of the system was the maintenance of the rupee at par with gold. When exchange showed signs of weakness, the Government were expected to come out as sellers of sterling (Reverse Councils), and when the rupee was tending to appreciate, to come out as sellers of the local currency (Council Bills). And the effectiveness of such Government interference depended upon the adequacy of the gold and rupee reserves.

§23. **Council Drafts system.**—The system of Reverse Councils and Council Bills was an important part of the Gold Exchange Standard system during the pre-War period. But the Government had never bound themselves by law to sell Reverse Councils or sterling bills, and, moreover, occasions for selling them were comparatively rare. But, as we have already seen, the system of Council Drafts (Council Bills and Telegraphic Transfers) was the fly-wheel of the machinery for the management of Indian currency, exchange, and finance.

The practice of drawing funds from India by the sale of bills of exchange on India dated from the time of the East India Company.[2] Up to 1893, however, the sale of Council Drafts[3] was, as a rule, limited by the actual requirements of the Secretary of State for meeting the Home Charges. The system enabled the Secretary of State to obtain funds at as favourable a rate as possible. It was also convenient to trade as providing a ready means of settling a large part of debts due to India from foreigners on account of India's surplus of exports over imports. In fact it was the existence of this surplus in normal times which made the system of Council Drafts possible and profitable.

For some years after 1893, a negative use, so to say, was made of the system for forcing up the exchange value of the rupee by a temporary cessation of the sale of Council Drafts. This had the

[1] op. cit., pp. 6-7. Elsewhere (p. 20), Mr Keynes describes the essentials of the Gold Exchange Standard as 'the use of a local currency mainly not of gold, some degree of unwillingness to supply gold locally in exchange for the local currency, but a high degree of willingness to sell foreign exchange for payment in local currency at a certain maximum rate; and to use foreign credits in order to do this'.

[2] The following account is slightly abridged from the *Chamberlain Commission Report*, pars. 170-6.

[3] 'Council Drafts' is a generic term including Council Bills and Telegraphic Transfers.

effect of making the rupee less freely available and tended to raise its price in terms of sterling.

We have already seen how, in 1898, after the rupee had at last risen to 1*s.* 4*d.*, Act II of 1898 authorized the sale of Council Drafts against gold set aside at the Bank of England as part of the Indian Paper Currency Reserve, and notes of corresponding value were issued in India to meet the Council Drafts. The object was not merely to draw funds from India to meet the Home Charges, but quickly to expand the currency in times of monetary stringency in India, as an alternative to the shipment of sovereigns to India on private account, when the Government of India had no surplus treasury balances with which to meet Council Drafts.

A further step was taken when gold accumulated in London, and, representing the proceeds of the sale of Council Drafts against the issue of notes in India, was regarded as available for the purchase of silver for coinage in India. Since 1904, as already seen, an offer to sell Council Bills was kept standing. A similar train of events resulted in the issue by the Secretary of State, as occasion required, of notifications offering to sell Council Drafts against sovereigns in transit from Australia or Egypt to India, the motive being to avoid the expense and the waste involved in the shipment of sovereigns first to India and then to London for the purchase of silver, sovereigns beyond a particular limit not being required in India.

In 1909 and 1910, Council Drafts were freely sold to obtain gold in London in place of the large quantities of rupees, which had accumulated in the Gold Standard Reserve in India through the sale of Reverse Councils in London during the crisis. The effect of this was to bring the Gold Standard Reserve Fund back to London.

Profits on the mintage of rupees, which necessarily first took the form of rupees, were converted into sterling in London, the rupees which represented the profits being issued in India to meet the Council Drafts sold in London.

The consideration affecting Council Drafts thus came to be very much wider than the mere question of putting the Secretary of State in funds for paying the Home Charges. To this purpose was added that of securing the convenience of trade and that of so manipulating the disposition and location of the resources of the Government as to give the fullest effect to Government policy in matters of currency, exchange and finance.

Before concluding this account a description may be given of the procedure adopted in selling the Council Drafts.[1]

[1] Now replaced by the system of Government purchase of sterling, which is discussed in the next chapter.

Whenever there was a demand for remittance to India and money was wanted for any purpose by the Secretary of State, on each Wednesday an announcement was made as to the total amount for which the Council Bills and Telegraphic Transfers (for which the rate was ordinarily higher by 1/32*d.* per rupee than that for the bills) were to be sold the next Wednesday. Tenders were invited from intending purchasers and allotment made to the highest bidder, subject to a minimum price. On intermediate days, Intermediate or Special Bills were made available at a somewhat higher rate, the exact rate and the maximum amount of such 'Intermediates' being fixed for the week each Wednesday.

The arrangements made each Wednesday were laid before the next meeting of the Finance Committee of the India Council and subsequently before the Council itself for approval.

§24. **Government resources and the claims on them.**—The Chamberlain Commission (whose recommendations have been noticed in the next section) have well described the nature of the resources available to the Government and the principles governing their use as follows: 'The first principle to be borne in mind in any consideration of the Indian finance and currency system is that the balances of the Government of India, and of the India Office in London, and the portions of the Gold Standard and Paper Currency Reserves located respectively in India and in London, all represent in the last analysis one single fund. The titles attached to the constituent portions of this fund indicate to some extent the nature of the needs and liability for which the fund as a whole is required to provide. The name attached to each portion indicates the primary function of that portion; but neither in theory nor in practice have the separate portions of the fund been entirely reserved for the objects indicated by their separate names.

'The needs and liabilities for which these resources were required to provide may be summarized under the following five heads:

'(i) A working balance in India for (*a*) the current expenditure on revenue and capital account of the Imperial and Provincial Governments throughout India; (*b*) the expenditure of local boards and municipalities for which the Central Government act as bankers; (*c*) the Government savings banks; and (*d*) miscellaneous funds and services, such as funds in Court.

'(ii) A working balance in the United Kingdom for the Home Charges of the Government of India on revenue and capital account, including the capital outlay of most of the Indian railway system.

'(iii) A reserve fund for the maintenance at par of the exchange value of the rupee with the sovereign.

'(iv) A fund for securing the convertibility of the notes of the Government of India.

'(v) The provision in India of fresh supplies of coined rupees and of sovereigns . . . at the official ratio. In addition, the system . . . is used to provide facilities for remittance to India by means of Council Bills and Telegraphic Transfers of such sums as may be required to meet the balance of trade in India's favour. This use of Indian balances is limited only by the amount of resources available in India to meet the sales, subject, however, to the notification that Bills will be sold indefinitely at 1*s.* 4⅛*d.* per rupee."[1]

§25. **The Chamberlain Commission.**—In view of the persistent and severe criticism of the Government's currency and exchange policy, a Commission was appointed in April 1913 with Mr (later Sir) Austen Chamberlain as its Chairman, and it reported in February 1914. Its conclusions and recommendations were as follows:

(i) The establishment of the exchange value of the rupee on a stable basis was a matter of the first importance to India. (ii) The measures adopted for the maintenance of the exchange value of the rupee had been necessarily and rightly rather supplementary to, than in all respects directly in pursuance of, the recommendations of the Committee of 1898. (iii) The crisis of 1907-8 was the only occasion upon which they had been severely tested, and they were found to work satisfactorily then. Owing to lack of experience in working the machinery and the absence of any plans fully worked out in advance for dealing with such a crisis, the Government did at first make mistakes. For example, the India Office seemed to believe that the sole, or at least the main, purpose of the Gold Standard Reserve was to meet the requirements of the Secretary of State in London, when Council Bills could not be sold, while the Government of India made the mistake of refusing to give gold from the Paper Currency Reserve for export, though allowing their gold to be drained away for internal use. Both the authorities failed to realize that the principal use of a gold reserve is that it should be freely available for foreign remittances whenever the exchange falls below specie point. These mistakes, however, were very quickly rectified in practice, and the steps taken to restore and maintain exchange proved adequate. (iv) The history of the previous fifteen years showed that gold currency in active circulation was not an essential condition of the gold standard, which had been firmly secured without this condition. (v) It would not be to India's advantage to encourage an increased use of gold in the internal

[1] See *Chamberlain Commission Report,* pars. 9-10. The account in the *Report* relates to the arrangements as they existed before the War.

circulation. (vi) The people of India neither desired nor needed any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consisted of rupees and notes. (vii) A mint for the coinage of gold was not needed for purposes of currency or exchange, but if Indian sentiment genuinely demanded it, and the Government of India were prepared to incur the expense, there was no objection in principle to its establishment either from the Indian or the Imperial standpoint, provided that the coin minted was the sovereign (or the half-sovereign); it was pre-eminently a question in which Indian sentiment should prevail. (viii) If a mint for the coinage of gold was not established, refined gold should be received at the Bombay mint in exchange for currency. (ix) The Government should aim at giving the people the form of currency which they demand, whether rupees, notes or gold, but the use of notes should be encouraged. (x) This internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling. (xi) No limit should be fixed to the amount up to which the Gold Standard Reserve was to be accumulated. Reliance ought to be placed on the Paper Currency Reserve for the support of exchange only in so far and so long as the Gold Standard Reserve was not adequate to support the burden by itself. (xii) The profits on the coinage of rupees should, for some time at least, continue to be credited exclusively to the Reserve. (xiii) A much larger proportion of the Reserve should be held in actual gold. By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about £10 millions in gold could at once be secured. This total should be raised, as opportunity offered, to £15 millions, and thereafter the authorities should aim at keeping one-half of the total Reserve in actual gold. While it was unnecessary and wasteful to hold the whole of the Gold Reserve in gold, the loss from enforced realization of securities in a time of crisis should be guarded against by maintaining a sufficient amount in liquid form. (xiv) The Indian branch of the Gold Standard Reserve should be abolished as it had given rise to much criticism, and was responsible for much confusion and doubt as to the efficiency of the Reserve. (xv) The proper place for the location of the whole of the Gold Standard Reserve was London. (xvi) The Government should definitely undertake to sell bills in India on London at the rate of 1*s*. 3 29/32*d*. per rupee whenever called upon to do so.[1]

The Commission thus gave its most unstinted approval to the nondescript currency system, which had been evolved more or less

[1] *Chamberlain Commission Report*, par. 223.

fortuitously. The Government had not always felt very comfortable under it, and responsible officials still spoke occasionally as if they regarded the Gold Exchange Standard, under which India found itself, as merely a wayside inn, the real destination being a gold standard with its usual accompaniment of a gold currency.[1]

In 1912, the Government of India, in sympathetic response to the agitation in the country in favour of a gold mint in Bombay which culminated in Sir Vithaldas's resolution referred to above, addressed the Secretary of State on the subject urging him not to turn a deaf ear to the popular demand for a gold coinage. The Chamberlain Commission, however, attempted to give a new turn altogether to the Government's thoughts. They practically assured them that, without knowing it, they had put India into the forefront of nations in currency matters by adopting the Gold Exchange Standard system.

Before the Government had had enough time to consider and give effect to the various recommendations of the Chamberlain Commission, the War intervened and created an altogether novel set of conditions and raised new problems which we now proceed to discuss.

Effects of the War on the Indian Currency [2]

§26. **The first period (August 1914 to autumn 1915).**—The effects may be considered under two main periods: (i) The first period extends from the outbreak of the War in August 1914 to autumn 1915. This was a period of dislocation involving a general weakening of the currency and exchange position.

(ii) The second period falls between autumn 1915 and the end of 1919. This may be considered as a period of revival and was characterized by great vigour in production. It witnessed a very large rise in the exchange and an unprecedented rise in the gold

[1] Sir James Meston, speaking in the budget debate of 1910, used the following words: ' We have linked India with the gold countries of the world. We have reached a gold exchange standard, which we are steadily developing and improving. The next and final step is a true gold currency. That, I have every hope, will come in time, but we cannot force it. The backwardness of our banking arrangements, the habits and suspicions of the people, the infancy of co-operation—all stand in the way. But the final step will come when the country is ripe for it. I trust that it will not long be delayed; for when it comes, it will obliterate all the mistakes, all the inconveniences, all the artificialities, of our present position.'

[2] This account is largely based upon the *Report of the Babington Smith Committee*, 1920.

price of silver, which was particularly pronounced towards the end of the period.

The outbreak of the War dealt a rude shock to public confidence and caused a general dislocation of trade and business. The principal symptoms of this were a weakening of the exchange, withdrawals of Savings Bank deposits, a demand for the encashment of notes, and a run on the Indian gold stocks.

The Government met the situation by prompt measures which helped the early restoration of confidence. The weakening of exchange was met by offering Reverse Councils, which were sold to the extent of about £8 millions up to February 1915, when the demand for Council Bills revived, and apart from short spells of weakness, Indian exchange remained strong throughout the second period, there being a very large demand for Council Bills, the whole of which could not be met.

A large amount—Rs. 6 crores out of a total of Rs. 24½ crores—was withdrawn from the Savings Bank deposits in the first two months of the War. The net withdrawals amounted to Rs. 8 crores, till the tide turned in 1915-16. The demands were freely met, and this proved useful in restoring confidence and attracting back the deposits, which again rose to Rs. 18 crores by the end of 1918-19 (i.e. Rs. 6½ crores less than the original amount).

The demand for the encashment of notes was also freely met, notes of the value of Rs. 10 crores being returned to the Treasuries up to March 1915. But from that time onwards there was a steady increase in the note circulation.

Lastly, there was a run on the Indian gold stock, which took the form of a keen demand for gold in exchange for notes. Precautions against the internal use of the gold so acquired proving useless, the issue of gold to private persons was altogether stopped, and notes were paid after that in silver coin only.

All these embarrassing symptoms disappeared by the end of the first period. The Government on the whole may be said to have faced the situation boldly and successfully. Public confidence was restored by the assurance given to the banking and commercial community of adequate and continuous facilities for remittance abroad and by the readiness with which the Government encashed currency notes as they were presented.

§27. **The second period (autumn 1915 to the end of 1919)** After the first shock of the War had passed away, the currency mechanism worked smoothly for some time, and it was not till the end of 1916 that acute complications arose. There was a rapid rise in the price of silver and an increasing difficulty of obtaining it to meet the heavy demands for silver coins in India.

In the first place there was a heavy excess of exports over imports, and the balance of trade, which was at the outset of the War unfavourable to India, became now embarrassingly favourable. Although the export trade had at first suffered on account of the War, it made a steady recovery, thanks to the insistent demand for India's exports on the part of the Allies for the prosecution of the War. The import trade, on the other hand, suffered more, as we have already seen.[1] The result was that there remained a large excess of exports over imports to be liquidated.

To make the situation still more difficult, the Government of India had to incur heavy (recoverable) expenditure on behalf of His Majesty's Government. From 1914 to December 1919, £240 millions had to be so spent on military equipment in the eastern theatres of the War and to meet civil expenditure in occupied territory. In addition to this, arrangements had to be made for the financing of purchases in India, on behalf of some of the Dominions and Colonies and also for the African importers of Indian produce.

The combined effect of these factors was to create a heavy demand for Indian currency. The decrease in the imports of precious metals on account of the restrictions placed on their export by foreign Governments further added to the ticklishness of the situation. As the pre-War methods of liquidating the favourable balance were not available, the Government had to provide some sort of a substitute to prevent the paralysis of the export trade so vitally necessary for the successful prosecution of the War. They had, therefore, to sell Council Bills in London on a very large scale by way of providing means of remittance to pay for Indian exports. To meet these Bills it became necessary to undertake extensive coinage of rupees. This was a task which presented almost insuperable difficulties as various circumstances conspired to send up the price of silver to undreamt-of heights.

§28. **Rise in the price of silver.**—The principal factor which dominated the currency situation was the extraordinary rise in the price of silver. There was a great shortage of the supply of the white metal as compared with its pre-War level of production, owing to internal disturbances in Mexico, and a great increase in its cost of production. On the other hand, there was an unusually keen world demand for the metal mainly for currency, on account of the shortage of gold and the almost universal anxiety on the part of belligerent and neutral governments to conserve their supplies of it. The heaviest demand came from India and China. We have already seen that the burden of liquidating the favourable balance

[1] Ch. vi, §5.

of trade and finding purchasing power for the expenditure on behalf of the British War Office was mainly thrown on the Government of India and took the form of large demands for the local currency, especially for rupees. The demand was further accentuated by the melting of rupees (notwithstanding its prohibition by law), when the intrinsic value of the coin exceeded its face value in the course of the great rise in the price of silver. Another factor which operated in the same direction was the influence of the dollar-sterling or the New York-London exchange. When it showed a tendency to move against England, it was 'pegged' or fixed by the action taken by both the Governments at \$4·76 : £1.[1] It was essential to do this in order to maintain smooth trading relations between the two Allies in the Great War. The movement of the dollar exchange against England was caused by England's excess of debits over credits in relation to America, and, secondly, by the practical suspension of the gold standard in England and the inflationary character of a virtually inconvertible paper currency with which the country was flooded. As a result of this a distinction between gold and the pound sterling came to be established, the pound sterling being depreciated in terms of the American gold dollar which was on an effective gold basis. When in March 1919 the sterling-dollar exchange was decontrolled, it made a further move against England, in response to economic forces which were now left unfettered, reaching eventually as low a limit as \$3·40 : £1 sterling.

Now the chief payment for silver purchased for India by the Secretary of State had to be made to America in terms of dollars, and the progressive depreciation of sterling raised the London sterling price and was bound to raise the rupee price of silver also, unless the rupee was given a correspondingly higher sterling value.

Having explained the causes of the rise of silver, let us now follow its meteoric flight. In 1915 the highest price of silver was 27 pence per ounce. In 1916, a maximum of 37 pence was reached. In August 1917, it exceeded 43 pence per ounce (which is the bullion par of the rupee, i.e. the price at which the exchange value of the rupee at 1*s*. 4*d*. is equivalent to its bullion or intrinsic value). In September 1917 the price rose to 55 pence. The United States, Great Britain and Canada, however, came to the rescue, all of them instituting a control over the trade in silver and prohibiting its export except under a license and later on except at a specified price. These measures resulted in the price of silver being kept within the limits of 41 and 49 pence per ounce. But in May 1919, the United

[1] The pre-War parity of this exchange was \$4·86 : £1.

States and the United Kingdom withdrew this control and a further rise in the price of silver occurred. In the same month it reached 58 pence per ounce, after which it continued its upward career throughout the year, reaching the level of 78 pence in December. The highest point was attained in February 1920, when the London quotation rose to 89 pence per ounce.

§29. **Measures taken by the Government.**—(i) *Government control of exchange.*—After the country had lived down the first shock of the War, the demand for Council Bills revived with the revival of the export trade. It was fairly normal till October 1916, after which it rapidly increased owing to the rising favourable balance which, we saw, could not be liquidated by the normal method of free imports of specie. This resulted in the depletion of the rupee reserves in India, endangering the convertibility of the notes. In December 1916, therefore, restrictions were imposed on the sale of Council Bills, and the sale of Intermediate Councils was stopped, with the result that there was a divergence between the market rate of exchange and the Government rate. This was detrimental to the export trade, which it was essential to maintain uninterrupted for the successful conduct of the War. Therefore, certain measures of control were instituted by the Government, exchange being fixed at 1*s*. 4¼*d*. in January 1917. The sale of Council Bills was confined to some selected banks and firms, and these were required to do business with third parties at the prescribed rates, applying their resources mainly to certain selected articles of export of importance to the Allies. With the co-operation of the banks assisted by these control measures, further fluctuations in the exchange were prevented for some time.

(ii) *Raising of exchange rate.*—Very soon, however, it was found that these measures were not of substantial use in maintaining exchange stability owing to the remarkable rise in the price of silver on which we have dwelt above. The Government could not go on selling rupees to the public at 16 pence when the cost of manufacturing a rupee became 18 pence, 20 pence and so on, with the successive rises in the price of silver. The Government did not entertain the suggestion made by some people in India that this loss should be debited to the Gold Standard Reserve, since it was meant for the very purpose of maintaining exchange stability. They denied that the Reserve was intended for such use and determined to shift this loss on to those who wanted rupees from them.

In pursuance of this policy, exchange was raised to 1*s*. 5*d*. in August 1917, and shortly afterwards the Secretary of State announced his intention to base the rates of exchange on the sterling

price of silver, raising them as the latter rose.[1] The result is shown in the following figures.

Changes in the Rates of Exchange

Date		Exchange in Sterling	Date		Exchange in Sterling
3 January 1917	...	1*s*. $4\frac{1}{4}$*d*.	12 August 1919	...	1*s*. 10*d*.
28 August 1917	...	1*s*. 5*d*.	15 September 1919	...	2*s*. 0*d*.
12 April 1918	...	1*s*. 6*d*.	22 November 1919	...	2*s*. 2*d*.
13 May 1919	...	1*s*. 8*d*.	12 December 1919	...	2*s*. 4*d*.

The market rate and, later on, the rates for the sale of the Reverse Councils, when these were sold from February 1920 onwards, were in the period from January to March 1920, 2*s*. 6*d*., 2*s*. 8*d*., 2*s*. 10*d*. and 2*s*. 11*d*., the highest rate being reached in the early months of 1920.

(iii) *Purchase of silver.*—Special measures had to be taken to increase the supply of currency, silver being purchased for the purpose from February 1916. To remove competition from private purchasers in India, the Government prohibited the import of silver on private account from September 1917. In 1918, as the result of negotiations with the Government of the United States, the latter passed the Pittman Act which authorized the sale of the silver in the reserve. The Government of India thus purchased 200 million ounces of pure silver at $101\frac{1}{2}$ cents per ounce fine.

(iv) *Conservation and economy of silver.*—Further measures were taken for the conservation and economy of silver. Currency legislation was passed in June 1917, prohibiting the melting and export of gold and silver coins. Notes of the denomination of 1 and $2\frac{1}{2}$ rupees were issued in December 1917. In January 1918, for the first time, nickel coins of the denomination of 2 annas, 4 annas and 8 annas were issued and made legal tender up to one rupee. From June 1917, the Government acquired gold imported on private account at a price based on the sterling exchange value of the rupee, irrespective of the premium on gold. Notes were issued against

[1] 'This announcement was equivalent to declaring the restoration of the silver standard in India like the one that was in existence before 1873. From 1873 to 1893, the measure of value in India was fluctuating with changes in the gold prices of silver. The gold price of 165 grains of silver at any moment was the measure of value for the exchange of goods in India. The same was true now in view of the conditions described above. . . . '—Vakil and Muranjan, *Currency and Prices in India*, p. 112.

gold so acquired, and gold mohurs and sovereigns were coined and issued as currency to supplement the silver currency. When the restrictions on the export of gold from America were removed in June 1919 and the gold markets of South Africa and Australia became free, more gold was imported into the country and acquired by the Government. To encourage its import, they raised the acquisition price so as to include the premium on gold as compared with sterling. Gold so obtained was sold to the public fortnightly from August 1919 with the object of lowering the premium on it.

(v) *Inflation of paper currency.*—Relief was also sought in an increase of the note issue without the usual metallic backing. Further, restrictions were placed on its convertibility, such as suspension of the extra-legal facilities for conversion. Another remedy resorted to was a limitation of daily issues of rupees to single tenderers of notes.

(vi) *Financial measures.*—The ordinary and the capital expenditure were kept as low as possible, and additional taxation was imposed to increase the Government's purchasing power. Further, large rupee loans were floated in India bringing in Rs. 130 crores in three years (1917, 1918 and 1919), a phenomenal figure as compared with the pre-War figures and expectations. Short-term Treasury Bills of from three to twelve months' duration were also issued in considerable quantities from October 1917.

All these measures materially assisted the meeting of the heavy demands for remittances to India and the direct demands for currency there.

§30. **The Babington Smith Committee.**—The War had broken out while the recommendations of the Chamberlain Commission were still under consideration, and, as we have just seen, the events of the War years had raised a crop of fresh problems and new difficulties. The Secretary of State, therefore, appointed, on 30 May 1919, another expert committee under the presidency of Sir Henry Babington Smith.

§31. **Importance of stability and means of attaining it.**—As the Smith Committee remark: 'For the current operations of trade, stability (of exchange) is an important facility rather than an essential condition.' But the evils of instability are intensified if the movements of exchange are brought about not by economic causes, but by administrative acts. The possibility of official intervention makes it difficult for the commercial community to provide against the risks of fluctuation. Stability of exchange, therefore, is particularly important in an unautomatic currency system like that of India. The Committee considered at first certain proposals which aimed at attaining stability at the old level of 1*s.* 4*d.*

One of these proposals was to reduce the fineness or the weight of the rupee so as to fix the exchange value at the old level and still maintain the token character of the rupee, however high the price of silver might rise. This was turned down by the Committee on the ground that the credit of the Government would be impaired by such a step. Gresham's law would come into operation, so that the old full-weight rupees would disappear from circulation, and on the whole the social and economic consequences would be undesirable.

Another proposal was that a two-rupee or three-rupee silver coin of lower proportional silver content than the rupee should be issued with the intention that it should circulate side by side with the existing rupee, the coinage of which would be temporarily suspended. The Committee rejected this proposal as being open to many of the objections to the first proposal, and adduced as a further reason against it that these units would be too large for the bulk of retail transactions in India. For similar reasons they opposed the suggestion in favour of nickel rupees.

Lastly, the proposal to introduce complete or partial inconvertibility of the note issue so long as the price of silver continued high also failed to commend itself to them. They feared that it would impair the Government's credit and destroy popular confidence, as the note-using habit was as yet too little established in India to render the introduction of such a measure possible without grave risks.

§32. **Recommendations.**—The question whether the exchange should be stabilized at the old level or somewhere near the new level which it had reached, was decided by the Committee in favour of the latter alternative, on the ground that it would shorten the period of uncertainty and prevent economic dislocation and social discontent (see §33). The following is a summary of the main recommendations of the Committee.[1]

(i) The rupee, unchanged in weight and fineness, should remain unlimited legal tender. (ii) It should have a fixed exchange value which should be expressed in terms of gold at the rate of one rupee for 11·30016 grains of fine gold, i.e. one-tenth of the gold contents of the sovereign. (iii) That the sovereign previously rated by law at rupees fifteen should be made legal tender in India at the revised ratio of rupees ten to one sovereign. (iv) The import

[1] The summary has been taken from Appendix 3 to the *Report of the Hilton-Young Commission on Indian Currency*, 1925-6, but the recommendations with regard to the constitution and location of the Paper Currency Reserve have been omitted.

and export of gold should be freed from Government control as soon as the change in the statutory rate to Rs. 10 had been effected, and a gold mint at Bombay should be opened for the coinage into sovereigns of gold tendered by the public. (v) The Notification of the Government undertaking to give rupees for sovereigns should be withdrawn. (vi) The prohibition of the private import and export of silver should be removed and the import duty on silver should be repealed unless the fiscal position demanded its retention. (vii) The Gold Standard Reserve should contain a considerable proportion of gold and the aim should be to hold the remainder of the Reserve in securities issued by Governments within the British Empire (other than the Government of India) maturing within twelve months. A portion of the gold held in the Reserve, not exceeding one-half, should be held in India.

The recommendation to fix the exchange value of the rupee at 2*s*. gold was qualified by the following remark :

'If, contrary to expectation, a great and rapid fall in world prices were to take place and if the costs of production in India fail to adjust themselves with equal rapidity to the lower level of prices, then it might be necessary to consider the problem afresh.'

§33. **The Committee's case for the high rate.**—The principal reason for the high rate recommended by the Committee was their expectation that, for a long time to come, the price of silver would continue to be high, and they thought that, if the exchange value of the rupee was fixed at a figure not lower than 2*s*. gold, the rupee would be once more established as a token coin, and the maintenance of a satisfactory monetary circulation would be assured.

A consideration of the general economic effects of a high rate of exchange also led them to prefer it. A low rate would mean high prices which would entail great hardship on the poorer classes and on those who had fixed incomes, and would promote great unrest and discontent.

Although the rise in the rate would stimulate imports and discourage exports, these effects were transitory in character and would disappear when wages and other elements of cost had adjusted themselves to the new rate of exchange. The export trade would no doubt suffer temporarily, but less than was feared by some people, because the demand for Indian goods abroad was very keen owing to the world shortage of raw materials and food-stuffs. Besides, the high rate of exchange and the general cheapening of the imports would bring substantial advantages to the Indian producer. It would tend to keep down the cost of imported stores and machinery in terms of rupees, and by reducing the cost of living in India it would lower wages or at least check their further advance,

Lastly, Government finances would stand to gain enormously from the high level of exchange, and the annual saving in respect of the sterling obligations would amount to Rs. 12½ crores, if the old ratio of 1*s.* 4*d.* was abandoned in favour of the new one of 2*s.* gold. There would of course be a loss involved in the revaluation in terms of rupees of the sterling investments and of the gold in London. But the whole of this loss would be wiped out in the course of three years by the savings effected in connexion with the Home Charges. And after this had been done, a considerable surplus revenue would remain and would be available for employment in further economic development of the country or in reducing taxation.

In recommending that the rupee should be fixed in relation to gold rather than to sterling, the Committee were influenced by the consideration that it was very desirable to stabilize the rupee as early as possible at a level which would ensure its remaining a token coin, and remove the necessity of further increase in its value to meet successive advances in the sterling price of silver occasioned by a progressive depreciation of sterling. They also argued that by linking the rupee with gold, at least one disturbing cause of exchange fluctuation would be eliminated, since any rise in the sterling price of silver would be counterbalanced by a similar automatic rise in the sterling value of the rupee. Moreover, if the rupee and the sovereign were both to remain legal tender in India and available for circulation, it was necessary that the relation of the rupee to the sovereign should be fixed, since two coins cannot remain in circulation and at the same time stand in variable relation to one another.

§34. **Mr Dalal's minute of dissent.**—Mr (now Sir) Dadiba Merwanjee Dalal wrote a stimulating and spirited minute of dissent differing from his colleagues in practically all their conclusions.

With reference to the Government's action in raising the rate of exchange in response to the rise in the price of silver, he refused to believe that the professed reason for this was the true or the only reason; for apparently the Government intended to maintain the rate at a higher level even if the price of silver should fall. In his opinion the rise in the price of silver could have been prevented by removing the embargo on the export of silver after the War had ended, and it was after the War that the greater part of the rise in exchange was brought into force. India could easily have spared the silver for export; such exports would have been profitable to her, and they could have prevented the great rise in the price of silver. It was mainly because the export of silver from India was

prohibited, and India was made a potential buyer instead of a seller, that the silver markets were inflamed and the price rose.

Mr Dadiba Dalal was entirely opposed to the rise in the rate of exchange, because he thought its consequences to India would be disastrous. It would seriously disturb the relations between creditor and debtor, cause dislocation and a setback to several Indian industries, and vast continuous losses on the exports of Indian produce, and turn India's balance of trade against her. A fixed high level of exchange would also cause enormous losses in the rupee value of the invested reserves in sterling securities and of gold held as part of the metallic reserves against the note-issue. Further, if the sovereigns held by the public were to be redeemed at the statutory rate of Rs. 15 to the sovereign, this would further entail a colossal loss.

An alteration of the ratio is at all times highly objectionable. The legal standard for money payments should be, and usually is, regarded as less open to repeal or modification than perhaps any other legislative act. It gives the people rights as to the kind of money they may demand in exchange for their labour or goods, rights which cannot be removed or modified without inflicting widespread injury and risking the gravest discontent.

Under the stress of the War, money standards were no doubt treated as of little account and there was extensive resort in most countries to inflation as a means of public finance. This however did not apply to India. The inflation of the Indian currency during the War was a genuine inflation as opposed to the artificial inflation in most of the belligerent countries. It arose from the balance of indebtedness due to India. It was caused by the acceptance in London of payments due to India in the form of sterling, which could not be transmitted to India in the usual manner through exchange operations or specie remittances.

Unfortunately, India had not been prepared financially for absorbing its favourable trade balances in any other form than the precious metals. There had been no encouragement in India for settling favourable trade balances by investments abroad. This was one of the disadvantages of the currency arrangements conducted by the Government. During the War, British Government loans could have been successfully floated in India, and it was also possible to do something by way of encouraging Indian investors to buy the Indian sterling loans held in London, if arrangements had been made at the Government district treasuries in India.

The break in the standard may have been justifiable during the War, but when the War was over, the people's rights in the standard money of the country should have been protected from further

modification. If the choice was between a certain amount of inconvenience to trade and abandonment of the legal standard, the former alternative should have been unhesitatingly chosen. It was for the trade to accommodate itself to the standard rather than the other way about.

The high price of silver was entirely artificial, and the removal of the embargo on its export combined with a refusal to raise the rate of exchange (and so far make the sale of silver unprofitable) would lower it. But even otherwise the Government could meet the situation by stopping the coinage of fresh rupees, of which the country had already more than enough, and by not selling Council Bills beyond the requirements of the Secretary of State.

Even assuming that only two alternatives were open to the Government, namely, raising the rate of exchange and debasing the silver coinage, the latter would be the lesser of the two evils.

There was no advantage in making the rate of exchange follow the price of silver. With the ruling high prices of silver, there was no longer any economy in using it instead of gold.

§35. **Government action on the Report.**[1]—The Government accepted the Committee's recommendations and took the following steps to put them into force:

(i) *Control of exchange.*—In January 1920 the demand for Council Drafts had ceased and a strong demand for Reverse Councils had set in. During January the drafts had been sold at a rate based on the rate of 2*s.* 4*d.*, which had been fixed for the sale of Council Bills. But in compliance with the Committee's recommendation, the Government notified that Council Drafts and Telegraphic Transfers would be offered for sale weekly by competitive tender with no fixed minimum rate; and that, in future, Reverse Drafts and Telegraphic Transfers would be offered in India, when occasion so required, at a rate based on the sterling equivalent of the price of 11·30016 grains of fine gold as measured by the prevailing sterling-dollar exchange, less a reduction representing the cost of remitting gold.

(ii) *Change in the legal tender value of the sovereign.*—The internal ratio of one sovereign for Rs. 10 could not be made effective so long as gold bullion continued to command a high premium over the price indicated by the ratio recommended by the Committee. We have already seen how, as far back as 1917, the Government had started the compulsory acquisition of gold imported on private account and how they had begun from September 1919

[1] See *Report of the Royal Commission on Indian Currency and Finance* (1925), vol. II, Appendix 3; also H. Stanley Jevons, *Money, Banking and Exchange in India*, ch. xv,

their series of fortnightly sales of gold with a view to reducing the premium on it. Gold, however, still commanded a high premium over the price recommended by the Smith Committee. In February 1920, the Government announced that, during the next six months, a minimum of 15 million tolas of fine gold would be sold; but this original programme was extended by further sales in August and September. After selling a large quantity at an average rate of Rs. 22 per tola, the gold sales were stopped in October 1920 and the price of gold, which had been controlled to some extent by the Government sales, again went up. This part of the Government's policy must therefore be pronounced a failure.

By Ordinance No. III of 21 June 1920, sovereigns and half-sovereigns ceased to be legal tender in payment or on account, but provision was made for their acceptance by the Government at the ratio of Rs. 15 during a moratorium of 21 days, on the expiry of which the restrictions on imports of British gold coin were also withdrawn. The sovereigns and half-sovereigns tendered at the currency offices and treasuries in the 21 days during which the moratorium continued amounted to about £2½ millions.

The Currency Committee's recommendation that the sovereign should be made legal tender in India at Rs. 10 instead of Rs. 15 was given effect to by the Indian Coinage (Amendment) Act, No. XXXVI of 1920. This Act restored the legal-tender character of the sovereign and half-sovereign which had been suspended by Ordinance No. III of 21 June 1920. The rate fixed by the new Act was Rs. 10 to the sovereign and instructions were accordingly issued to treasuries and currency offices that sovereigns and half-sovereigns, if presented, should be received at the rate of Rs. 10 and Rs. 5 respectively, but that they should not be issued. As the market price of the sovereign continued to be above Rs. 10, it never functioned as currency at the new ratio. It was therefore thought unnecessary to open a gold mint in Bombay.

(iii) *Abolition of War-time restrictions.*—In February 1920 the prohibition on the import of silver (but not on export) was removed, and also the import duty of four annas per ounce which had been levied was abolished. Similarly, the War-time notifications which had been issued prohibiting the use of gold and silver coin otherwise than as currency, or dealing in them at a premium, were also cancelled. The fall in the price of silver and the return of silver coin from circulation, which commenced in May 1920, made possible the abolition of the remaining War-time restrictions on the movements of precious metals. On 21 June the restrictions on the import of gold bullion and foreign coin were removed. A few days later restrictions on the use of silver for making payments

on behalf of the Government were withdrawn, and treasury officers were instructed that payments should in future be made in the form of currency desired by the payee. Steps were also taken in the direction of renewing the extra-legal facilities (for conversion of notes into rupees) which had been temporarily withdrawn. The treasury officers, for example, were instructed as far as possible to give silver in exchange for notes if presented in reasonably small quantities. In short, so far as silver was concerned, full effect was given to the recommendations of the Currency Committee before the end of 1920.

The measures taken with reference to the reconstitution of the Paper Currency Reserve will be referred to later on.

§36. **Sale of Reverse Councils.**—We must now recount in greater detail the Government's attempt to maintain the new ratio of 2*s*. gold and the ghastly failure with which it met. On the date of the publication of the Smith Committee's Report the American cross-rate[1] had reached the low level of £1 : $3·65. It was obvious that the existing rate of the rupee-sterling exchange must rise very considerably, if the Government were determined to keep the value of the rupee at 2*s*. gold. Indian exporters in these circumstances were anxious to discount their export bills as quickly as possible in order to save themselves from the expected rise of exchange. But this rush of the exporters to turn their bills into rupees was itself bound to send up the sterling value of the rupee, which, accordingly, rose to 2*s*. 8½*d*. within three days of the announcement of the 2*s*. gold ratio. Another fall in the American cross-rate caused a further rise in the rate of exchange, which stood at the unprecedented figure of 2*s*. 10¼*d*. on 11 February. After this, however, a reaction set in. The rush of the exporters to discount their bills had abated. The demand for sterling on the other hand became more and more intense owing to the Government's decision about the ratio. Commercial firms and private persons hastened to make their remittances to England, which in the ordinary course of things would have waited for several months, in order to take advantage of the abnormally high rate of exchange.

As a result of the huge War-time profits made by certain sections of the people, there was a heavy boom of company flotations and this meant orders on an unusually large scale for foreign plant and machinery, of which the cost was remitted in advance in order to make the best of the high rate of exchange so long

[1] 'The rate of exchange between London and New York is spoken of in India as "the American cross-rate" or as the "New York cross-rate". A cross-rate is the rate of exchange between any two places outside of one's own country.'—Stanley Jevons, op. cit., p. 217 n.

as it lasted. There was also a good deal of speculation in exchange, as it was easy to make handsome profits by the simple process of first turning rupees into sterling when the rate was high, and then translating sterling back into rupees when the exchange came down, as the speculator hoped and anticipated it would.

This heavy demand for sterling made for a rise in its value, that is, a fall in the value of the rupee. The divergence between the market and the official rate which thus arose and which at times amounted to as much as 3*d.* or 4*d.* further stimulated the demand for the Reverse Councils.

By far the most important cause, however, responsible for the sagging of the exchange was the tendency towards the adverse balance of trade referred to above as having commenced in January 1920. This tendency gathered momentum with every month that passed. The Government at first started selling Reverse Councils at rates based on 2*s.* 8*d.* sterling on 5 February. The rate was raised to 2*s.* 10 27/32*d.* on 12 February, but thereafter it decreased as sterling appreciated. By the end of June, the balance of trade had begun to turn strongly against India, with the result that the market rates of exchange had not merely departed from the parity of gold, but had fallen below the parity of 2*s.* sterling. After this the Government tried to maintain the rate at 2*s.* sterling. Consequently at the sale of 24 June and subsequent sales the rate adopted for Immediate Telegraphic Transfers was 1*s.* 11 19/32*d.* The reason advanced was that this represented the rate which would ultimately hold when sterling returned to parity with gold. But in reality it meant that the Government had given up hope of giving effect to the 2*s.* gold rate recommended by the Smith Committee, which thus had mounted, shone, evaporated and fallen—all within the brief space of less than six months. The market rate of exchange continued to fall without the Government being able to arrest its downward career. They were compelled to reduce their own rates following the market rate, and the only principle that was adopted was to keep the official rate at a somewhat higher level than the market rate. But this could not last indefinitely, and the Government finally abandoned their attempt to regulate the exchange. At the end of September 1920, the sales of Reverse Councils since the beginning of the year had amounted to £55,382,000. The Reverse Councils were paid in London out of the proceeds from the sale of sterling securities and Treasury Bills belonging to the Paper Currency Reserve. These securities and bills had been bought at the rate of Rs. 15 to the pound, but they were sold at rates ranging from Rs. 7 to Rs. 10.

The difference between the selling and buying price measured an aggregate loss of Rs. 35 crores to the Indian exchequer.

Apart from the heavy losses suffered by the Indian exchequer in connexion with the sale of the Reverse Councils, the eventual collapse of the exchange was ruinous to business in more ways than one. A very considerable deflation of money had occurred as the result of the sale of the Reverse Councils. The note circulation between 1 February and 16 September 1920 had been reduced from Rs. 185 crores to Rs. 158 crores by the process of cancelling the notes received by the Government in payment for Reverse Councils. This very substantial withdrawal of currency had proved ineffective for maintaining exchange owing to the abnormal activity of the import trade and the absence of any support from exports. But it caused an acute monetary stringency, and was responsible for a fall in the level of prices. Both these circumstances together greatly enhanced the difficulties of business men, who were compelled to sell off their stocks at ruinously low prices.

The heaviest loss, however, was due to the fact that the commercial community had relied on the Government maintaining the exchange at the high rate chosen by them. Goods had been ordered in the confident expectation that exchange would remain high, but the exchange had fallen heavily by the time they arrived. This meant nothing less than bankruptcy to many importers whose reliance on Governmental ability to keep the exchange at the desired high level was so complete that they had failed to take the usual precaution of covering their exchange.

§37. **Government policy examined.**—All this, however, may fairly be taken as proving that many sagacious and hard-headed business men did not regard the maintenance of the high rate as an impossible task, whatever they may have thought about its advisability.

The Government themselves had no doubt in their mind about the practicability of maintaining the ratio at 2*s*. gold, being reassured on this point by the majority report of the Babington Smith Committee. It is true that Mr Dalal in his able dissenting minute had argued strongly against the high ratio and dwelt at length on the evils sure to follow from it. But he does not seem to have laid any particular emphasis on the *impossibility* of maintaining the ratio for any length of time.

It is, however, a very strange phenomenon that the feeling about the impracticability of maintaining the new ratio was not as common as it might have been expected to be. When the Government set out to give effect to the recommendations of the

Babington Smith Committee, there were several facts before them which might have given them pause in initiating such a revolutionary change in the currency standard. For example, in August 1920, when the altered ratio was to have come into effect, gold was selling at Rs. 23¼ per tola, whereas according to the new ratio the price of gold ought to have been Rs. 15-14-0. In view of such a great disparity it should have been clear that it would be extraordinarily difficult, if not impossible, to maintain the ratio of 2*s.* gold. Again, the price of silver itself had gone down to about 44*d.* per ounce and therefore the danger of rupees being melted down had practically disappeared. Moreover, even if a certain amount of melting had taken place this would not have mattered much considering the vast volume of rupees in circulation.[1]

The Babington Smith Committee had entirely misread the situation when they put the rise of silver in the forefront of causes explaining the rise in the Indian exchange. The most important cause of the rise in the sterling value of the rupee was the greater rise in sterling prices as compared to the rise in rupee prices. According to the Purchasing Power Parity doctrine, the rate of exchange had to move up in sympathy so as to bring about equilibrium. The same doctrine explained the subsequent fall in the exchange which was due to the more rapid decline of world prices (or sterling prices) since 1920 than the Indian prices. This turned the tables against the rupee, causing a fall in its sterling value during, and for some years after, 1920, before it began to appreciate again and ultimately reached 1*s.* 6*d.*[2] The 2*s.* gold rate meant a considerable overvaluation of the rupee in comparison with its purchasing power parity with gold at the time, and the attempt to give a fixed gold value to the rupee was premature, as the value of gold itself was undergoing the most violent variations and the conditions of international trade were still extremely unstable.[3]

[1] See Ambedkar, op. cit., p. 207.

[2] 'The rise in the price of silver was really a mere coincidence due to a large extent to speculation. In ignoring the significance of the rapidly altering price-levels and fixing its attention merely upon the speculative prices of silver, lay the fundamental error of the Smith Committee's Report on Indian Currency. In linking the rupee to gold at 2*s.*, it overlooked the real character of the rise which had taken place and underestimated the deflation which would have become necessary to maintain that rate. Its surmises regarding the probable course of prices in other countries were perhaps the most ridiculous examples of economic prophecy to be met with in history.'—Vakil and Muranjan, op. cit., pp. 340-1.

[3] See Gustav Cassel's Memorandum, *Hilton-Young Commission Report*, vol. III, Appendix 92.

The high price of silver was partly the result of the depreciation of the rupee as well as of sterling in terms of commodities in general. Even supposing, however, that the rise in the price of silver had been the chief cause of the rise in the exchange, the former was largely speculative. The tremendous range of variation in its prices as shown in the following table[1] should have served as a warning that the rise was without an element of permanence and stability.

Price of the Silver Ounce in Sterling (Pence)

Year	Highest	Lowest	Average	Range of variation
1916	37 1/8	26 11/16	31 5/16	10 7/16
1917	55	35 11/16	40 7/8	19 11/16
1919	79 1/8	47 3/4	57 1/16	31 3/8
1920	89 1/2	38 1/2	61 7/16	50 5/8
1921	43 3/8	30 5/8	37	12 3/4

The only defence the Government might have put up was that, having appointed an expert Committee, they felt bound to follow its advice, especially as they could not see their way clearly before them owing to the entirely exceptional circumstances then prevailing. But the gravamen of the charge against the Government was not that they shaped their policy in the beginning in accordance with the advice of the Babington Smith Committee, but that having seen the palpable futility of the efforts to make the 2*s.* gold rate effective, they still persisted in the sale of Reverse Councils. By the end of June 1920, it was fairly clear that the task which the Government had taken upon themselves was an impossible one, and it would have been a courageous and wise step frankly to have acknowledged defeat at an early stage. As it was, however, they persevered in their ill-advised attempt to bolster up the exchange, dissipating their huge gold resources in the process and causing tremendous disturbance in the industrial and commercial

[1] Ambedkar, op. cit., p. 204.

world. Thus as Sir Stanley Reed put it, 'a policy which was avowedly adopted to secure fixity of exchange produced the greatest fluctuations in the exchanges of a solvent country and widespread disturbance of trade, heavy losses to the Government, and brought hundreds of big traders to the verge of bankruptcy '.[1]

§38. **The policy of masterly inactivity (1921-5).**—After the failure of the attempt to stabilize exchange, the Government had to be content for some time with watching, in a spirit of patient expectancy, the course of events as they unfolded themselves, without taking any decisive action.

In the year 1921, the balance of trade was still against India. The depressed condition of the export trade was due to a rapid fall of world prices in terms of gold and the still more rapid fall of sterling prices owing to the steps taken by England to bring sterling back to gold parity. Under these circumstances, the expected happened and the sterling value of the rupee fell steadily. In the course of the year 1921, the Government had contracted the currency to the extent of Rs. 31,58,000. This, however, was not enough to arrest the downward course of exchange, which was driven to as low a level as 1*s*. 3*d*. The contraction of currency was continued further in 1921-2 and 1922-3 by the transfer of sterling securities held in London to the Secretary of State's cash balance and by the discharge of Indian Treasury Bills held in the reserve. With a view to preventing the further fall of the rupee the Secretary of State had also discontinued the sale of Council Drafts.

In 1922-3 the export trade of India showed a revival owing to good harvests and an improvement in the purchasing capacity of the European countries. The joint result of the contraction of currency and the revival of exports was to raise the exchange value of the rupee slowly but steadily. In September 1923 the rupee was equivalent to about 1*s*. 3⅛*d*. gold, and the pre-War ratio of 1*s*. 4*d*. could have been easily restored without adversely affecting any interest whatsoever, as was unsuccessfully urged by the Indian Merchants' Chamber. The Government, however, were apparently trying to take the ratio up to 1*s*. 6*d*., and the rupee as a matter of fact reached the level of 1*s*. 6*d*. sterling in October 1924. The Government's action after this was directed towards preventing the rise of the rupee much beyond this point. In order to achieve this result, the method of purchase of sterling required for Government remittances and, when necessary, in excess of this requirement, was freely used, and fresh currency was issued against these purchases, thus incidentally relieving to some extent the

[1] Quoted by B. E. Dadachanji, *History of Indian Currency and Exchange*, p. 137.

monetary stringency occasioned by the Government policy of deflation. The exchange value of the rupee reached 1*s.* 6*d.* gold in April 1925, and remained—or, as the critics of Government put it, was held—there until 21 September 1931.[1]

The end of the policy of masterly inactivity was now in sight. The Government of India in response to repeated requests from various quarters promised an inquiry into the currency situation early in 1925 through an authoritative committee before the end of the year, by which time they anticipated that the world conditions would become sufficiently stable. On 25 August 1925 a Royal Commission on Indian Currency and Exchange was appointed under the presidency of Lt.-Commander Hilton-Young.

Before considering the deliberations and decisions of the Commission, we shall turn aside to give an account of the evolution of the Indian Paper Currency system, which perhaps has already been delayed too long.

Indian Paper Currency

§39. **Early history.**—Under the Acts of 1809, 1840 and 1843 the Presidency Banks of Bengal, Bombay and Madras were authorized to issue notes payable to the bearer on demand subject to certain regulations as to maximum issue and reserves. But their circulation was restricted within narrow bounds, being practically confined to the three Presidency towns. In 1860 James Wilson, the first Finance Member of India, worked out a scheme for a Government Paper Currency and the abolition of the right of note-issue enjoyed by the Presidency banks. Sir Charles Wood, the then Secretary of State for India, laid down the following principles on the lines of the English Bank Charter Act of 1844:

The function of note-issue should be entirely separated from that of banking, as was also suggested by Wilson, and, second, as Sir Charles Wood put it, 'the amount of notes issued on Government securities should be maintained at a fixed sum, within the limit of the smallest amount which experience has proved to be necessary for the monetary transactions of the country, and that any further amount of notes should be issued on coin or bullion '.[2] Accordingly, the Paper Currency Act of 1861 was passed. Unlike England, India was at first divided into three circles of issue, with headquarters at Calcutta, Bombay and Madras. The number of circles subsequently grew, and settled down to seven in 1910, the four additional circles being Rangoon, Karachi, Cawnpore and Lahore. Notes were issued of the denominations of Rs. 10, 20, 50,

[1] See ch. viii. [2] See Keynes, op. cit., p. 39.

100, 500, 1,000 and 10,000. A note of smaller denomination, viz. the five-rupee note, was introduced in 1891. They were to be issued to the public without limit in exchange for rupees or British gold coins, and in exchange for gold bullion on the requisition of the Controller of Currency. They were declared unlimited legal tender both at the Government Treasuries and in private transactions, but within their respective circle of issue.

A reserve was formed in bullion and coin to the full value of the notes issued with the exception of a certain small portion invested in the Government of India Rupee Securities as a guarantee of their convertibility.

The notes could be encashed as of right only at the head office of the circle of issue. At the same time Government Treasuries cashed notes of other circles for bona-fide travellers and for the railway companies. Payment of Government dues could be made in the currency notes of any circle.

§40. **Restrictions as to encashment and legal tender.**—India is a vast country, and the conditions of trade caused large movements of money from one part of the country to another at different times of the year. The first use of notes would therefore be for remittance in a more convenient way than by sending specie. The Government would have been obliged to send cash from place to place if they had not restricted the legal tender quality of the notes to the circle of issue. If, on the other hand, the notes had been made universal legal tender but only encashable at Presidency towns, there would undoubtedly have been a premium on coin at certain times of the year which would have impaired the popularity of the notes.

The Circle system, however, greatly restricted the normal expansion and popularity of notes, and the first step was therefore taken in 1903 to abolish it, when the five-rupee note was made universal legal tender except in Burma, this restriction being removed in 1909. In 1910, notes of the denomination of Rs. 10 and 50 were similarly universalized and power was taken to universalize notes of higher denomination by executive order. In 1911 accordingly, the Rs. 100-note was universalized. The Chamberlain Commission recommended the universalization of the Rs. 500-note also. The Rs. 500- and Rs. 1,000-notes were made universal legal tender during 1931-2.[1] This process of universalization led to a rapid expansion of the total circulation of notes. Extra-legal facilities for encashment of notes had been provided at the Government Treasuries in various places, and the Presidency Banks

[1] *Report of the Controller of Currency* (1931-2), par. 60.

undertook further to extend such facilities at their head offices and branches. The War period arrested any further development in this direction, as there were difficulties in getting enough rupees coined and the uncovered note issue also increased. The Babington Smith Committee recommended the abolition of War-time restrictions and further extension of extra-legal facilities for the encashment of notes as essential for making them more popular, and accordingly they have been revived.

§41. **Paper Currency Reserve.**—The Act of 1861 provided for a fixed maximum fiduciary issue in the form of Government securities up to four crores of rupees. The limit was changed from time to time by special Acts: to six crores in 1871; in 1890 to eight crores; in 1897 to ten crores; and in 1905 to twelve crores. Up to this time the securities were the rupee securities of the Government of India held in India, but the Act of 1905 authorized the holding of sterling securities in England up to two crores. Since 1905, part of the invested portion of the reserve has thus been in the form of sterling securities.[1] In 1911, the maximum reserve in securities was fixed at fourteen crores, four crores of which was to be in sterling securities.

As already pointed out, up to 1898, the whole of the Paper Currency Reserve, except a fixed fiduciary portion, was held in silver coin in India. In 1898, the Gold Note Act authorized the Government to hold any part of the metallic portion of the reserve in gold coin. The Act of 1900 gave authority to hold part of this gold coin in London. The Act of 1905 gave the Government full power to hold the metallic portion of the reserve, or any part of it, either in London or in India, and in gold coin or bullion, or in rupees or silver bullion, with the proviso that all coined rupees were to be held in India only.

As pointed out above, except for a fixed maximum fiduciary issue, which was raised from time to time, the whole of the rest was held either in gold and silver bullion or coin. With the gradual expansion of the note issue, an ever-diminishing proportion came to be invested as a result of this practice. On the other hand, a growing proportion came to be held in a liquid form, sometimes as much as 80 to 85 per cent. This was due to a deliberate change of policy and to the use of the liquid part of the reserve for a new purpose, namely, that of supporting exchange whenever necessary. In fact, as we have already seen, this was considered as the first line of defence of the currency system as a whole.

The result of the policy was that a superlatively safe reserve was held for ensuring the convertibility of the notes, but at the

[1] *Ante,* §18, p. 310.

cost of economy. This could have been avoided by increasing the invested portion, the best way of doing which was to make cash bear a certain percentage of or proportion to the total issue of notes. In this way also the frequent resort to legislation to raise the fiduciary limit could have been avoided.

§42. **Composition of the Paper Currency Reserve criticized.**— The following table[1] gives an idea of the composition and location of the Paper Currency Reserve in the pre-War period.

In lakhs of rupees

Last day of March			Total note circulation	Composition and location of the Reserve						Percentage of Securities to total Reserve
				Silver	Gold		Securities (purchase price)			
				India	India	England	India	England	Total	
1862-71	(average)	...	7,63	4,80	3	...	2,80	...	2,80	37
1872-81	,,	...	11,82	5,98	...	...	5,84	...	5,84	49
1882-91	,,	...	15,74	9,64	...	...	6,10	...	6,10	39
1892-1901	,,	...	27,29	15,74	2,32	23	9,00	..	9,00	33
1902-11	,,	...	43,82	19,45	9,15	4,02	10,00	1,20	11,20	26
1912	...	...	61,36	15,48	23,33	8,55	10,00	4,00	14,00	23
1913	...	...	68,98	16,45	29,38	9,15	10,00	4,00	14,00	20
1914	...	..	66,12	20,53	22,44	9,15	10,00	4,00	14,00	21

The main criticism against the pre-War composition of the Paper Currency Reserve was against (i) the unduly large metallic reserve; (ii) the impossibility of increasing the fixed fiduciary reserve except by special resort to legislation; and (iii) investment of part of the Paper Currency Reserve in sterling securities in England.

(i) and (ii) made the system generally inelastic. As regards (iii), the practice was sought to be justified on the ground that the sterling securities were useful for maintaining the exchange value of the rupee and that they possessed the additional advantage of not being liable to depreciation in the event of an internal crisis in India. As against this it was argued that the maintenance of the exchange value of the rupee was not the proper function of the Paper Currency Reserve, that even sterling securities were liable

[1] See Findlay Shirras, *Indian Finance and Banking*, p. 256.

to depreciation in the event of a crisis in England and that public confidence in the note issue could only be secured by holding the whole of the reserve in India.[1]

The function of note issue was entirely dissociated from the function of banking and there was nothing like a central bank and therefore no Government banker. There was the Reserve Treasury system, under which public funds were locked up in special Government Treasuries (except for small amounts confided to the Presidency Banks), bringing about a stringency in the money market during the busy season of the year.

The internal currency was absolutely inelastic for special and general purposes, and there was no provision for its temporary expansion except by importing funds from abroad either by the purchase of Council Bills or import of sovereigns. Similar defects have been overcome in other countries by the use of deposits and cheques, as in England and the United States, or by special temporary issue of paper currency against commercial bills of exchange, and lastly by placing Government funds at the disposal of a central bank.

The first method, namely that of cheques and deposits, is not much in use in India except at the few big commercial centres. The second was suggested by the Smith Committee and has been accepted. The third was also adopted by abolishing the Reserve Treasuries and placing the Government funds with the Imperial Bank of India which acted between 1921 and 1935 (before the inauguration of the Reserve Bank) as the Government bank. In order to remedy the general inelasticity two methods were suggested by the Chamberlain Commission and the Smith Committee respectively. The former recommended that the fiduciary reserve should be fixed at the amount of notes held by the Government in the Reserve Treasuries plus one-third of the net circulation (i.e. gross circulation *minus* the amount held in Reserve Treasuries). The principle is that the fiduciary issue should not exceed a maximum percentage of the total issue. The Smith Committee suggested that the metallic portion should not fall below a minimum percentage of the total issue; the proportion suggested being 40 per cent, although they held that it would be desirable to maintain a substantial margin above the statutory minimum, especially in the busy season. In either case, the fiduciary reserve would increase automatically with the increase of circulation without frequent resort to legislation. The system would thus be more economical and less rigid. As we shall see later on, the Government accepted

[1] See next chapter for further criticism of the location of the Paper Currency Reserve.

the Smith Committee's suggestion in 1920, although they adopted a higher percentage for the metallic reserve, viz. 50 per cent.[1]

§43. **The effects of the War on the paper currency.**—We saw above how, on the outbreak of the War, there was at the outset a general feeling of panic which led to a severe run on the Paper Currency Offices, notes of the value of ten crores being returned within the first eight months of the War. As already remarked, however, there was a gradual revival of confidence and a steady increase in the note circulation. The effects of the War on the paper currency from March 1915 onwards may be summarized as follows:

(i) Inflation of paper currency caused by the great demand for currency, which could not all be met by a fresh issue of rupees. The causes of this abnormal demand have already been discussed. (ii) As the result of successive Acts the fiduciary reserve increased tremendously, as is shown by the following table.

In crores of rupees

Acts	Permanent investments	Permissible temporary investments	Total
Act VII of 1911 (pre-War) .	14	...	14
Act V of 1915	14	6	20
Act IX of 1916	14	12	26
Act XI of 1917	14	36	50
Act XIX of 1917	14	48	62
Act V of 1918	14	72	86
Act II of 1919	14	86	100
Act XXVI of 1919	20	100	120

These Acts were supplemented by Ordinances issued by the Governor-General. This striking expansion of the invested reserve was necessitated by the difficulty which the Government experienced in finding enough coin to be held in the reserve. Also recoveries of the War expenditure in India incurred on behalf of England were made in London by the Secretary of State, and it being considered inadvisable in the Imperial interest to hold these proceeds in gold earmarked for the Paper Currency Reserve in London, the alternative of investing them in British Treasury Bills or short-term sterling securities was adopted,[2] although a part was invested in Indian Treasury Bills as well. (iii) The fall in the metallic reserve from 78·9 per cent in 1914, to 35·8 per cent in 1919. (iv) New notes of the low denomination of Re. 1 and Rs. 2½ were issued in

[1] See §44.

[2] The investment in the British Treasury Bills was partly dictated by the consideration that, being short-dated, there was small danger of their depreciating. The other sterling securities, on the other hand, were depreciating to a considerable extent as a result of the War.

December 1917 and January 1918 respectively as a measure of economizing silver, apparently in imitation of the issue of £1 and 10*s*. notes in England in the War period. The public did not at first take kindly to them. But the one-rupee note made steady headway and its circulation on 31 March 1919 amounted to Rs. 10,50 lakhs as compared with Rs. 1,84 lakhs in the case of the other note.[1] (v) The abolition of extra-legal facilities[2] for encashment owing to the scarcity of rupees, the notes thus running to a discount of as much as nineteen per cent in some places—particularly the new notes of smaller denominations. (vi) The import of 200 million ounces of American silver released under the Pittman Act to meet the Paper Currency crisis of April 1918.

The subjoined table brings out clearly the effects of the War on the composition and location of the Paper Currency Reserve.[3]

In lakhs of rupees

Last day of March	Total note circulation	Composition and location of the Reserve							Percentage of securities to Total Reserve
		Silver	Gold			Securities (purchase price)			
		India	India	England	Total	India	England	Total	
1914 ...	66,12	20,53	22,44	9,15	31,59	10,00	4,00	14,00	21
1915 ...	61,63	32,34	7,64	7,65	15,29	10,00	4,00	14,00	23
1916 ...	67,73	23,57	12,24	11,92	24,16	10,00	10,00	20,00	29
1917 ...	86,37	19,21	12,00	6,67	18,67	10,00	38,49	48,49	56
1918 ...	99,79	10,79	26,85	67	27,52	10,00	51,48	61,48	62
1919 ...	153,46	37,39	17,37	12	17,49	16,08	82,50	98,58	65
1920 ...	174,52	39,80	...	...	47,70	...	...	86,86	50

§44. **Reconstitution of the Paper Currency Reserve.**—In September 1919, by the temporary amendment of the Paper Currency

[1] The Government of India decided to discontinue the issue of Re. 1 and Rs. 2½ notes definitely from 1 January 1926. Their place has been taken partly by silver rupees and partly by Rs. 10 notes.

[2] As has already been mentioned, these facilities were restored in 1920-1 and have since been extended by the multiplication of the branches of the Imperial Bank which provide for the encashment of notes as a matter of public convenience.

[3] See Shirras, op. cit., p. 264.

Act, the maximum limit to which the Currency Reserve could be invested was raised to Rs. 120 crores, out of which Rs. 100 crores had to be British Treasury Bills.

In March 1920, a temporary Act for six months was passed which permitted the retention of the invested portion of the reserve at Rs. 120 crores. But it abolished the restrictions as to the locale of the investments and their sterling or rupee character. This was necessitated by the then existing demand for remittances to London and the impossibility of meeting it from the Secretary of State's cash balances. The continued demand was therefore to be met by the disposal of the sterling securities held in the Paper Currency Reserve in London. This, however, involved, under the existing law, the withdrawal and cancellation of currency notes in India to the extent of the rupee value at which the sterling securities were held in the reserve, i.e. at the rate of Rs. 15 to £1.

In order to place the paper currency system on a satisfactory basis in the light of the criticism to which it was subjected by the Chamberlain Commission and the Smith Committee, and the experiences gained during the War, it was felt necessary to pass new legislation to replace the temporary Act of March 1920. Consequently, the Indian Paper Currency Amendment Act[1] became law on 1 October 1920. The provisions of this Act fall under two classes, permanent and transitory.

(i) *Permanent provisions :*[2]

(*a*) The metallic reserve was to be at least 50 per cent of the total reserve. The reasons for accepting a higher percentage than that suggested by the Smith Committee, which was only 40 per cent, were the necessity of encashing the notes without question in a country like India, and the necessity of holding sufficient coin in the reserve to finance the movements of the crops during the busy season, when notes are generally presented for encashment on a very large scale.

(*b*) With the exception of Rs. 20 crores worth of securities held in India, the remainder was to be held in England in short-term securities not exceeding a period of 12 months, as suggested by the Smith Committee.

(*c*) The Controller of Currency was authorized to issue notes up to an amount of Rs. 5 crores against inland discounted bills of exchange maturing within 90 days of their issue. This extra

[1] This is usually referred to as the Paper Currency Act of 1923, which was a Consolidating Act.

[2] These provisions are practically identical with the recommendations of the Smith Committee.

issue was to take the form of a loan to the Imperial Bank which was to pay 8 per cent interest to the Government and deposit accepted bills of exchange with the latter. (The limit of 5 crores was raised to 12 crores by the Indian Paper Currency Amendment Act of 1923.)[1] The provision regarding the fifty per cent statutory metallic reserve was irrespective of this extra issue, which was not to be considered for the purpose of fixing the metallic reserve.

(*d*) The Secretary of State was not to hold more than five million pounds in gold bullion in London.

(ii) *Transitory provisions :*

Owing to the difficulty caused by the necessity of revaluing the gold and the sterling securities of the reserve on the basis of Rs. 10 to the sovereign instead of Rs. 15, certain transitory provisions became necessary pending the final attainment of the permanent provisions. With revaluation on the 10-rupee basis the metallic portion of the reserve would have been less than fifty per cent. It was therefore provided that the invested portion might, for the time being, be fixed at Rs. 85 crores.[2] (The former limit of 12c was now unnecessary, as the circulation had been reduced to some extent by the sale of Reverse Councils met by the sale of sterling securities.) Another difficulty was about filling up the gap caused by the revaluation of the gold and sterling securities at two-thirds of their former value. This was easily solved by authorizing the Government of India to create rupee securities of their own hand (*ad hoc* securities, as they were called) and issue them to the Paper Currency Reserve. As these created securities would exceed the limit on rupee securities laid down by the Act, it was provided that the excess should be reduced by gradually replacing them with sterling securities. But as there were no funds immediately available to purchase a large quantity of sterling securities, it was provided that the interest derived from the securities in the Paper Currency Reserve as by law, and profits on the fresh coinage of rupees, and interest on the Gold Standard Reserve when that

[1] Of the 12 crores the first 4 crores could be issued when the Bank rate was 6 per cent, the next 4 crores when it was 7 per cent, and the last 4 crores when it was 8 per cent. The procedure was revised in September 1924, when the following regulations were issued:

(i) No loan shall be made unless the Bank rate rises to 6 per cent.

(ii) The entire amount outstanding at any time shall bear interest at the Bank rate subject to a minimum of 6 per cent for the first 4 crores and of 7 per cent for the subsequent 8 crores.

[2] As a remedy for monetary stringency, this limit was raised to Rs. 100 crores by the Amending Act of February 1925, which also laid down that the total amount of created securities of the Government of India was not to exceed Rs. 50 crores.

exceeded £40 millions (which it did on 30 September 1921), and lastly, interest on commercial bills of exchange deposited with the Controller of Currency as security for the temporary issue, should be paid into the Paper Currency Reserve to reduce such of the created rupee securities as were above the permissible figure of Rs. 12 crores. The Permanent provisions of the Act would thus be eventually carried into effect. On account, however, of the unsatisfactory financial position, Finance Acts of subsequent years allowed these sources of income to be diverted to revenue, except in 1921-2, when the excess in the Gold Standard Reserve was used for the extinction of the *ad hoc* securities.

On 1 April 1927, the gold and the sterling securities held in the Paper Currency Reserve, which since 1920 had been valued at Rs. 10 to the sovereign, were re-valued at the rate of Rs. 13-1-3 to the sovereign in accordance with the provisions of the Indian Currency Act, 1927, which came into force on that date. The result of this was an increase of Rs. 930 lakhs in the holding of gold and sterling securities, which was set off by cancelling the same amount of Indian Treasury Bills, the holding of which was reduced from Rs. 49,77 lakhs to Rs. 40,47 lakhs.[1]

§45. **The composition and location of the Paper Currency Reserve between 31 March 1925 and 1935.**[2]

In crores of rupees

On 31 March	Gross circulation	Silver coin in India	Gold coin and bullion in India	Silver bullion under coinage	Securities: Rupee in India	Securities: Sterling in England	Internal Bills of Exchange	Percentage of securities to total reserve
1925	184·1	70·2	22·3	6·7	57·1	20·1	8·0	40·8
1926	193·3	77·2	22·3	7·6	57·1	29·0	...	44·6
1927	184·1	95·9	22·3	8·5	49·7	5·5	2·0	31·1
1928	184·8	98·7	29·7	7·6	37·9	3·7	7·0	26·4
1929	188·0	94·9	32·2	4·9	43·2	10·6	2·0	28·7
1930	177·2	108·1	32·2	2·8	33·8	0·1	...	19·1
1931	160·8	117·8	25·8	6·9	10·2	...	...	6·3
1932	178·1	102·0	5·2	9·2	57·9	...	3·8	32·4
1933	176·9	96·3	26·0	15·5	39·1	...	...	22·1
1934	177·2	86·5	41·5	11·5	29·5	8·2	...	21·2
1935	186·1	77·2	41·6	13·1	35·9	18·3	...	29·1

[1] For the recommendations of the Hilton-Young Commission regarding the paper currency see the next chapter. The transfer of the note issue function to the Reserve Bank of India and the new arrangements regarding the reserve held against notes with effect from 1 April 1935, under the Reserve Bank of India Act (1934), are dealt with in ch. x.

[2] See *Reports of the Controller of Currency*, from 1924-5 to 1934-5. The figures of the composition and location of the Currency Reserve subsequent to 1 April 1935 are given in ch. x.

The above table reveals certain striking changes in the Paper Currency Reserve between the years 1925 and 1935. Firstly there was a very appreciable decline in the gross circulation of notes in the years 1929-30 and 1930-1 owing to the contraction of currency largely in consequence of the superfluity of cash following the general fall in the prices of commodities which commenced in the latter part of the year 1929-30 in the wake of the Wall Street collapse in New York. Another factor was the tendency towards exchange weakness due partly to the fall in the prices of the great staples of export trade and partly to the tendency towards the transfer of capital abroad in view of the uncertainty of the political situation in India and the speculation regarding reversion to the old statutory ratio of 1*s.* 4*d.* This increased the difficulties of making remittances to the Secretary of State to meet the Home Charges, and goes far to explain the total disappearance, by 1931, of sterling securities in the Paper Currency Reserve, since these securities had to be transferred to the Secretary of State against corresponding contraction of notes in India.[1] The big drop in the holdings of rupee securities in 1930-1 is explained by further contraction of currency in 1930-1 against these securities. The decrease in the amount of gold in the reserve in the same year was caused by the payment of Rs. 8⅓ crores of gold into the Indian branch of the Gold Standard Reserve against withdrawal of sterling securities of the value of £6·2 million forming part of that reserve in England, in aid of the Home Treasury balances and to meet sales of sterling at the statutory rate of 1*s.* 5 49/64*d.* between November 1930 and February 1931 in response to the public demand which was influenced by the exchange speculation referred to above and the political situation in the country. Another remarkable change in the composition of the Paper Currency Reserve was the increase in the holdings of silver coin in the reserve owing to reasons explained below.[2] This increase would have been greater but for the removal of some quantity of silver for sale as recommended by the Hilton-Young Commission.

The total amount of silver sold by the Government of India from the commencement of their operations in 1927 up to 31 March 1935 amounted to 228,182,255 fine ounces. The sale proceeds were invested in sterling securities which were transferred to the Gold Standard Reserve against an opposite transfer of gold from that Reserve to the Paper Currency Reserve, an equivalent amount of rupee securities in the Paper Currency Reserve being simultaneously cancelled. The surplus balance obtained by sterling purchases in

[1] See also next chapter, §24.

[2] See §46.

excess of the current requirements of the Secretary of State was utilized in the same way. These transactions involved an increase in the gold holdings of the Paper Currency Reserve,[1] and a corresponding reduction in the balance of rupee securities. The sale of silver also involved a reduction in the holdings of silver coin and bullion in the Paper Currency Reserve. In 1933-4 and in the following years the surplus Home Treasury Balances and sale proceeds of silver were utilized in purchasing sterling securities and thus adding to the sterling assets of the Paper Currency Reserve—a welcome strengthening of the position on the eve of the transfer of Government currency activities to the Reserve Bank.[2]

In recent years, since the sale and export of gold on private account from India which commenced towards the end of September 1931, there has been an appreciable increase in the amount of gross circulation of notes, which stood at Rs. 186·1 crores on 31 March 1935 and at Rs. 214·70 crores on 31 December 1937. This expansion of currency has been attributed partly to the recent upward trend of prices and the public demand for currency to serve as a substitute for the gold in hoards, of which about Rs. 308 crores were exported up to the end of December 1937 mainly under the stimulus of the high rupee prices of gold following the fixing of the rupee to sterling at 1*s.* 6*d.* after Britain went off the Gold Standard on 20 September 1931.[3]

§46. **Note circulation and currency absorption.**—In this section it is proposed to discuss three main questions: (i) Gross and active circulation of notes; (ii) Character of the note circulation; and (iii) Absorption of various forms of currency.

(i) *Gross and active circulation of notes.*—When we speak of the circulation of the paper currency, we must be clear as to whether we are referring to gross or active circulation.

(*a*) By gross circulation is meant the value of all notes that have been issued and have not been paid off. (*b*) Active circulation since 1 April 1935, when the note issue function was taken over by the Reserve Bank of India, has meant the amount of notes issued less those held in its Banking Department.[4]

[1] The gold holdings of the Government of India on 31 March 1935—on the eve of their transfer to the Reserve Bank—amounted to Rs. 44·42 crores, of which 41·55 crores was in the Paper Currency Reserve and 2·87 crores in the Gold Standard Reserve valued at the statutory parity (i.e. Re. 1 = 8·47 grains of gold). Their actual market value on that date was approximately Rs. 76 crores.

[2] See ch. x. *Reports of the Controller of Currency* (1933-4), par. 39 and (1934-5), par. 31.

[3] See next chapter for further explanation (§27).

[4] See ch. x.

The following table illustrates the growth of average gross and active circulation of paper currency between 1904-5 and 1936-7.

TABLE I

In crores of rupees

Year	Gross	Active	Year	Gross	Active
1904-5 ...	39·2	28·1	1929-30 ...	183·1	163·0
1906-10 ...	49·6	37·2	1931-2 ...	163·6	152·6
1913-14 ...	65·5	46·6	1932-3 ...	173·8	152·0
1914-15 ...	64·0	45·4	1933-4 ...	178·1	157·4
1917-18 ...	101·7	71·8	1934-5 ...	183·2	161·6
1919-20 ...	171·6	151·1	1935-6 ...	192·2	163·0
1923-4 ...	179·0	156·9	1936-7 ...	202·0	175·4
1927-8 ...	180·1	162·6			

The welcome increase in active circulation in recent years shows the increasing use of notes in the country and is indicative of business recovery.

(ii) *Character of the note circulation.*—The following statement indicates the relative popularity of the different denominations of notes on 31 December 1936 and 31 March in preceding years. For the purpose of this statement Rs. 10,000-notes are excluded as they hardly enter into ordinary circulation at all, being used as a convenient means of effecting large transfers between the Imperial Bank and Government currency chests.

TABLE II

Period	Percentage to gross circulation of the circulation of notes for									
	Re. 1	Rs. 2-8	Rs. 5	Rs. 10	Rs. 20	Rs. 50	Rs. 100	Rs. 500	Rs. 1,000	Total
1913-14 ...	...	...	3·2	34·9	0·2	3·5	35·0	5·2	18·0	100
1918-19 ...	7·8	1·4	6·8	34·8	...	3·6	32·5	1·9	11·2	100
1921-2 ...	6·2	0·2	10·0	36·3	...	2·5	34·2	1·3	9·3	100
1923-4 ...	6·6	...	9·3	33·4	...	1·8	40·5	0·9	7·5	100
1926-7 ...	0·3	...	9·9	43·7	...	1·3	36·1	0·7	8·0	100
1928-9 ...	0·2	...	13·2	41·4	...	1·1	36·5	0·6	7·0	100
1931-2 ...	0·2	...	13·2	41·1	...	0·9	37·3	0·4	6·9	100
1933-4 ...	0·2	...	12·9	40·2	...	0·8	38·8	0·4	6·7	100
1934-5 ...	0·2	...	13·5	39·5	...	0·7	35·5	0·3	10·3	100
1936[1] ...	0·2	...	16·5	40·2	...	0·8	35·9	0·2	6·2	100

This table shows that the Rs. 10- and Rs. 100-notes are by far the most popular. The old pattern Rs. 50-note declined in its popularity owing to its large size and its superficial resemblance

[1] As on 31 December.

to the old pattern Rs. 10-note. The Rs. 2½-note was never popular and its issue along with that of the Re. 1-note was discontinued, as already stated, since 1 January 1926, and these notes are being cancelled on receipt at treasury and currency offices. The Rs. 20-note was pushed out of existence by the Rs. 10-note on the one hand and the Rs. 100-note on the other and ceased to be issued with effect from 1910. A new pattern note of Rs. 50 denomination, of a considerably smaller size, was introduced during the year 1930-1, but its issue has had no effect on the proportion of the note circulation as yet. In view of the fact that the circulation of Rs. 50- and Rs. 500-notes is negligible the Reserve Bank of India has recently (1938) decided not to issue its own notes of these denominations, though Government of India notes of these denominations will continue to be legal tender.

(iii) *Absorption of various forms of currency.*—The following statement[1] shows the average annual absorption of currency notes and rupee coin:

TABLE III

In lakhs of rupees

	Rupees	Notes	Total
Average for five years 1909-10 to 1913-14	8,77	3,01	11,78
Average for five years 1914-15 to 1918-19	22,08	16,72	38,40
1919-20	20,09	20,20	40,29
1920-1	−25,68	− 5,90	−31,58
1923-4	7,62	7,96	15,58
1925-6	− 8,11	1,16	− 6,95
1926-7	−19,76	− 3,40	−23,16
1927-8	− 3,71	10,22	6,51
1928-9	− 3,03	3,66	63
1929-30	−21,71	−18,80	−40,51
1930-1	−21,58	−11,37	−32,95
1931-2	3,93	17,24	21,17
1932-3	− 7,56	−14,83	−22,39
1933-4	− 30	13,54	13,24
1934-5	− 3,21	− 32	− 3,53
1935-6	− 9,46	1,82	− 7,64
1936-7	− 2,49	25,53	+23,04

[1] Sovereigns and half-sovereigns have been omitted in the above statement. From 1 April 1927 they ceased to be legal tender and from 1914 they did not function as currency. Since the Reserve Bank assumed the management of currency on 1 April 1935, the figures for absorption or return of currency are arrived at in the following manner. The absorption or return of currency is the variation in the totals of notes in circulation as shown in the returns of the Issue Department of the Bank. Notes in circulation thus now include amounts held in Government treasuries as well as notes in circulation among

The above table shows striking changes in the relative popularity of the various forms and absorption of currency before, during and after the War. The War-time expansion of currency on a large scale in the form of both rupees and notes due to factors already examined is brought out by the figures. The large contraction of currency in 1920-1 represents the effects of the adverse balance of trade and the sale of Reverse Councils. In recent years there has been a tendency towards the return of silver rupees from hoards on the one hand and the replacement of coin by notes to some extent on the other. One of the causes for the return of rupees from hoards is the substitution of gold bullion for rupees in hoards as a store of value under the influence of the considerable drop in its price in India below its pre-War level, before the rupee price of gold rapidly rose in consequence of India going off the gold standard with effect from 21 September 1931. (See next chapter.) The increasing popularity of notes, the spread of banking facilities and the freer acceptance of bearer cheques has decreased the demand for rupees. The practice of privately railing rupees has been declining rapidly. The drop in recent years in the prices of certain staples of trade like cotton and jute, and the general trade depression, have been responsible for the lessened consumption of coined rupees and notes. The currency policy of the Government in these years was criticized on the ground that there was excessive contraction of currency in 1929-30 and 1930-1 which created a shortage of money in the country, producing a fall in prices and inconveniencing trade. Sir George Schuster, however, pointed out that the reduction in the volume of currency was a sequel to the fall in world prices and had not been carried to an excessive extent.[1] In recent years the absorption of note currency has increased, although partially set off by a return of silver coin. We have already referred to the public demand for note currency to serve as a substitute for the gold in hoards, now being sold and exported. The study of the absorption of currency month by month reveals the fact that currency is absorbed generally in the busy season from November to June and returns to currency offices and treasuries in the slack season from July to October.[2]

the public. The absorption or return of rupee coin means the decline or rise respectively in the amount of the rupee coin held in the Issue Department of the Bank. For the method of calculating the absorption of currency before the inauguration of the Reserve Bank see the old annual *Reports of the Controller of Currency.—Report on Currency and Finance for the years 1935-6 and 1936-7*, par. 47 (published by the Reserve Bank of India).

[1] *Central Budget for 1931-2*, pp. 28-9; and see also ch. viii, §24.

[2] See also ch. x, §§27 and 30.

CHAPTER VIII

CURRENCY AND EXCHANGE—PART II

THE HILTON-YOUNG COMMISSION AT WORK

The report of the Hilton-Young Commission was published on 4 August 1926. The recommendations of the Commission fall conveniently under the following three heads: (i) Choice of a Monetary Standard; (ii) The Ratio of the Stabilization of the Rupee; and (iii) Creation of a Reserve or Central Bank of India. The first two of these subjects will be considered in this chapter and the third will be dealt with in the chapter on Banking and Credit.

§1. **Defects of the gold exchange standard.**—Before propounding their own scheme of a monetary standard for India, the Commission indicated the following defects of the system as it existed:[1]

(i) The system was far from simple, and the basis of the stability of the rupee not readily intelligible to the uninstructed public.[2] The currency consisted of two tokens, rupees and rupee-notes, in circulation, with the unnecessary excrescence of a third full-valued coin (sovereign), which did not circulate at all. One form of token currency (rupees) into which there was an unlimited obligation to convert the other (rupee-notes), was highly expensive and was liable to vanish if the price of silver rose above a certain level, when it ceased to be a token coin.

(ii) There was a cumbrous duplication of the reserves, namely, the Gold Standard and Paper Currency and Banking Reserves, with an antiquated and dangerous division of responsibility for the control of currency and credit policy, which in other countries is

[1] See *Hilton-Young Commission Report*, par. 21.

[2] The basis was not only not readily intelligible, but it had also other faults. Mr Denning, Controller of Currency, wrote: 'The system did not provide for the automatic stabilization of the rupee. The legal obligation to give rupees in exchange for sovereigns would have prevented the rate of exchange rising above the upper gold point, even if the Government had not been prepared to meet fully the demand for Council Bills at 1*s.* 4⅛*d.*, but there was no statutory safeguard against a fall in the rate of exchange below the lower gold point. In practice, such a fall in the rate of exchange was prevented by the sale of Reverse Councils, but Government were under no statutory obligation to take such action.' See *Hilton-Young Commission Report*, vol. II, Appendix.

centralized in and fixed upon a central bank. In India, the Government controlled the currency, and the credit situation, so far as it was controlled at all, was controlled by the Imperial Bank.

(iii) The system did not secure automatic expansion and contraction of currency. Such movements were too wholly dependent on the will of the currency authority, that is, of the Government. The system did not automatically enforce contraction of internal currency concurrently with the depletion of the reserves.[1]

Similarly, with regard to expansion, on occasions the obligation to buy sterling had been discharged by the Government without any corresponding expansion of currency. The purchases had in the first instance been made against Treasury balances and the currency expansion had been left to be effected at the discretion of the Government.

(iv) Lastly, the system lacked elasticity. The utility of the provision for elasticity made on the recommendation of the Smith Committee was affected by the methods of financing Indian trade. These are based on a system of cash credits or the advance of money against demand promissory notes. There is, therefore, a shortage of genuine inland trade bills as cover against the seasonal increase of currency. The Government had, therefore, to announce in September 1924 that, as far as might be necessary, they would use their powers to issue currency against Treasury Bills deposited in the Paper Currency Reserve in London.

Other points of criticism not prominently brought out by the Hilton-Young Commission Report but already sufficiently familiar to currency controversialists may conveniently be brought together here.

§2. **Reserves and balances.**—We have already seen how reserves and balances created for a particular purpose were indiscriminately utilized for all sorts of purposes. The utilization of the reserves and balances was never governed by a consistent policy, with the result that they were sometimes treated separately and at other times mixed up, thus causing a great deal of confusion.

The position as regards the composition of the Gold Standard Reserve was unsatisfactory. It was mainly invested in long-term

[1] As Mr Denning points out in his Memorandum to the Commission, the provision for the automatic contraction of currency was particularly defective. 'In so far as the sterling value of the Reverse Councils sold was obtained by realizing sterling securities in the Paper Currency Reserve, the currency was contracted, but Government could arrange, by borrowing from the Gold Standard Reserve, to meet sterling payments on account of Reverse Councils without affecting the amount of currency in circulation.' See *Currency Commission Report*, vol. II, Appendix.

securities and a very small part of it was held in a liquid form. The Chamberlain Commission recommended that a large proportion of it should be held in a liquid form[1] and in easily realizable securities and that the silver branch of the Gold Standard Reserve should be abolished. The latter suggestion was carried out by the Government, but the other recommendations could not be given effect to owing to the outbreak of the War. During the War almost the whole of the reserve was held in securities in London, and British War Bonds and Treasury Bills were purchased. The recommendation that the securities should be easily realizable was carried out by investment in short-term securities.

The Smith Committee recommended that it was desirable to hold a considerable proportion of the reserve in gold. They also recommended that the securities should be short-term securities issued by the Government within the British Empire other than the Government of India.

The position of the Gold Standard Reserve, before its amalgamation with the Paper Currency Reserve and transfer to the Reserve Bank of India with effect from 1 April 1935,[2] was that it was largely held in London mainly in short-term paper of various kinds, as shown by the following figures.

Details of the balance of the Gold Standard Reserve on 31 March 1935 :[3]

	£
In England—	
Estimated value on 31 March 1935 of the sterling securities of the nominal value of £36,480,000 ...	37,845,529
Gold	2,152,334
Cash at the Bank of England	2,137
Total ...	40,000,000

Most of the Gold Standard Reserve and a part of the Paper Currency Reserve was placed in London. The Chamberlain Commission justified the location of the Gold Standard Reserve in London on the ground that London was the clearing house and the loan market of the world. Further, India's principal customer was the United Kingdom, and London was the chief place where money was required both for the expenditure of the Secretary of State on India's behalf and for the payment of India's commercial

[1] See p. 319 above.
[2] See §31 below and ch. x.
[3] For further details of investments, see *Report of the Controller of Currency* (1935-6), Statement xvii.

obligations to England and the world in general. If the reserve were kept in India, it would have to be shipped to London, involving unnecessary delay and expenditure. Also there was no short-loan market in India, and the location of the reserve there would be wasteful because it would be unable to earn any interest. Again, the practice of holding foreign bills followed by the Central Banks in certain European countries provided an analogy to the Indian system of holding the reserve in London.

These complicated arrangements regarding the location of the reserve were possibly primarily intended for meeting situations of exchange weakness caused by an unfavourable balance of trade. In view of the fact, however, that an unfavourable balance of trade is an abnormal phenomenon in the case of India (occurring about once every ten years) it was not necessary to maintain such elaborate standing arrangements to meet what is after all a rare contingency.

The Secretary of State could have easily put himself in funds for meeting his expenditure without the reserve being kept in London for this purpose. And clearly the main object of the reserve was not the convenience of the Secretary of State in this respect.

As regards the absence of a short-loan market in India, it was not true that there was no scope for short-term investment in this country, as the experience during the War and after has proved. In any case, interest could not be considered to be the decisive factor in determining the location of the reserve.

Other countries, even if they have an unfavourable trade balance as the normal feature of their international trade, do not usually maintain a reserve at foreign centres. There is no such reserve, for example, kept by any foreign country in India itself on the ground that year after year it has to make payments to India in settlement of trade obligations.

With regard to the Paper Currency Reserve, it was an anomalous position that the reserve intended for securing the convertibility of the notes circulating in one country should, instead of being kept there, be to any extent located at another place 6,000 miles away, thus impairing the confidence in the note issue. One of the reasons given for this practice was that London was the cheapest and best organized market for silver, for the purchase of which it was convenient to hold ample funds in hand. But if England, not being a producer of silver, is yet the best market for silver, there was no reason why an equally efficient market for the metal could not have been developed in India if the Government had consistently made their purchases in the country itself. Instead of making any

attempts in these directions, the Government may be said to have actually impeded the development by the imposition of an import duty on silver. Again, even supposing purchases were to be made in London, there was no particular harm in transferring funds from India when they were actually wanted instead of holding them there in advance. The inconvenience and additional expense would have been well worth while as tending to allay popular suspicion and discontent. It would also seem that in circumstances of urgency, arrangements could have been made for raising the necessary funds in England, for example, with the assistance of the Bank of England, pending the transfer of money from India. Lastly, the secrecy in which the dealings in connexion with the purchases of silver were shrouded naturally led to much adverse criticism.

§3. **Management of remittances.**—As we have already seen, the sale of Council Drafts by the Secretary of State was the machinery employed for drawing funds from India to London. The complaint in this connexion was that unnecessarily large amounts were transferred from India to London by this method, especially since 1904. This was defended on the ground that it enabled the Secretary of State to strengthen his financial position. No explanation was, however, offered why such strengthening was needed. Similarly, it was said that it was desirable that the Secretary of State should avail himself of exceptionally profitable rates for the Council Bills whenever they could be obtained. Here again the assumption is tacitly made that the question whether the funds were required was of subordinate importance. It was often claimed that by drawing more money than was immediately required for his expenditure the Secretary of State made possible an avoidance or reduction of debt. But these excessive drawings encouraged the policy of surplus budgets in India. Instead of the avoidance or reduction of debts, remission of taxation in India would have been a more worthy object to pursue.[1] Besides, it was noticed that even when the Secretary of State's cash balances were ample, large floating loans were raised in London.

The superfluous money which accumulated in the hands of the Secretary of State in this manner was loaned out in London at very low rates of interest to 'approved' borrowers, of whom a list was maintained by the Secretary of State. Complaints were common that a good deal of favouritism was shown in the administration of these loans, and colour was lent to these complaints by the fact that the members on the Finance Committee

[1] See ch. xi, §§27-30.

of the Secretary of State's Council were often themselves directors and business men who were interested in selecting the recipients for these loans.

Another practice that was objected to was that the Council Bills were often sold at rates below the specie import point even when there was no urgent necessity for funds in London.

One of the principal justifications urged for the sale of Council Bills beyond the requirements of the Secretary of State was that it was a great help to the foreign trade of India. But the trade was fully capable of looking after itself and would have had no difficulty in finding alternative means of financing itself, as in fact it had done with sufficient ease whenever the sales of Council Bills happened to be curtailed. There was thus no overwhelming reason why the Government should have gone out of their way to assist trade. All that they need have done was to make gold freely available for export whenever required.

The Council Bill system had all the appearance of an elaborate device for diverting the flow of gold from India and saving London the inconvenience and cost of finding it for India, 'while acting as a receptacle for as much of India's gold as possible—not to hold but to use'.[1]

In his memorandum to the Babington Smith Committee, Sir Stanley Reed pleaded forcefully for an abolition of the control over the Indian exchanges exercised by the Secretary of State. He urged that the Government of India, and to no less a degree the Secretary of State, were suspect in the eyes of a large section of the Indian community. The Secretary of State, he pointed out, operated 6,000 miles from the great Indian financial centres. 'He was surrounded by, and naturally amenable to, interests not Indian in their ideas and aims. He acted in secret, and it was frequently impossible to obtain any information in India of the groundwork of measures which, however wise and expedient in themselves, were not understood and were liable to perversion in India. The political disadvantages of such complete powers being exercised in secret so far from the people vitally affected by them could not be easily exaggerated.'

The real objection to the Indian system was not that it was managed—for in most civilized countries management in some form or other is essential—but that it was ill managed, or at least such was the widespread opinion held about it by the great majority of those Indians who gave any thought to these matters. In the words of Professor Nicholson, 'it is a bad thing for a country

[1] See *Indian Currency and Finance* ('Times of India' Press, 1913), p. 57.

when the masses of the people begin to feel that something is wrong with the currency ', and, whatever the inherent excellences of the gold exchange standard, it certainly had made the people of India think that something was very wrong with their currency system.

§4. **Inflation of currency and rise of prices.**—The Hilton-Young Commission, as we saw, pointed out that the Indian system was unautomatic[1] and was especially defective on the side of contractibility of superfluous currency. One of the inevitable results of this was an inflation of currency and an excessive upward movement of Indian prices.[2] As Professor Nicholson pointed out in his criticism of the Report of the Chamberlain Commission, since the convertibility of the rupee was partial and often suspended, it was unavoidable that in course of time, if new additions continued to be made, the cumulative effect must come into operation, causing a general rise in prices.

With the best intentions in the world, the Government were liable to grave errors of judgement in ascertaining the currency requirements of the country.[3] The demand for rupees often appeared to be quite sound and necessary without its really being so, and misjudgements were particularly easy as the rupees once issued to the public went up-country and did not come back quickly.

§5. **A haphazard and expensive system.**—The gold exchange standard in India had resulted from a series of administrative notifications not consistently informed by any deliberately adopted ideal. Many of the practices that had come into vogue as integral parts of the system had no legal validity. As Mr Dalal remarked in his Minute of Dissent (pars. 59-60), the system as a whole was never clearly and explicitly defined, and this had a general unsettling effect.

The gold exchange standard was often commended for its cheapness relatively to a gold standard proper. But if we allow

[1] *Ante*, §1. [2] See ch. ix.

[3] 'Here in India, Government has been attempting too much; it has taken upon itself the whole task of providing the necessary supply of currency, and adjusting it to varying needs of different occasions—a task not completely entrusted even to a banking institution in any other great country of the world—a task beyond its ability and one that exposes it to undesirable pressure. . . . In fact since the closing of the mints the Indian currency system has been managed at the whim of the latest official sent out from England. One man could come along and stuff the currency, the next would starve it. There has been no plan at all . . . but always some fresh experiment advised —a gold mint, prohibitive duties on silver bullion—anything or everything.' Moreton Frewen's evidence before the Chamberlain Commission. See also H. L. Chablani, *Studies in Indian Currency and Exchange*, pp. 93-4.

their proper value to all its disadvantages as detailed above, it would be excusable if we concluded that the cheapness of the system was very dearly bought indeed !

The system had also failed to destroy the hoarding habit and teach the people to appreciate the benefits of economical forms of currency.[1]

§6. **Internal versus external stability.**—In order to be quite fair to the gold exchange standard, we must count its successes as well as its failures. One of the achievements with which it has been credited has been that it gave the country a long period of exchange stability. Of course it broke down utterly during the War, but this happened to almost every other currency in the world. And on the whole, the gold exchange standard succeeded in keeping the foreign exchanges more stable than under the silver standard. We must, however, hasten to add that not all its critics are inclined to admit even so much. They point out that even if the War period is excluded from consideration, the system could not be said to have stood the test proposed for it. The only time that it was put to the proof before the War was during the crisis of 1907-8, and then it was kept standing only with the help of outside supports. The Government had to give an undertaking to borrow, if necessary, to maintain the standard, and were compelled to increase taxation in order to lay down gold. It was therefore only a fair-weather system, which threatened to collapse at the least sign of a storm. However, even if we admit that prolonged stability of exchanges was one of its positive achievements, we must put against this the internal instability of prices with a general tendency towards a rise which it occasioned. Most economists agree that stability of internal prices is far more important than stability of the foreign exchanges. Besides, the gold exchange standard system was not the only possible way of obtaining stability of exchanges. Under a gold standard system also it is possible to have not only stable prices but also stable exchanges. But it was not adopted in spite of the incessant clamour for it.

These imperfections of the system had created much distrust, which had been further intensified by too much being left to executive action and by the absence of statutory regulation of the duties of the Government as the currency authority. A substantial measure of external stability had been attained in the past. But what was lacking was the certainty and simplicity so necessary to ensure confidence in the currency system and to wean the

[1] See also §15.

uninstructed public from hoarding and the disinclination to investment.[1]

§7. **Proposals for reform.**—The Commission examined certain alternative proposals for reform, viz. (i) an improved sterling exchange standard;[2] (ii) a gold exchange standard;[3] and (iii) a gold standard, with or without a gold currency.

They rejected the sterling exchange standard as well as the gold exchange standard on the ground that, however improved, they would both always remain at the mercy of the price of silver, any rise in which above the melting point of the rupee would involve the disappearance of the coin. Besides, under any exchange standard, the note would be internally convertible into silver rupees only and not into gold. The sterling exchange standard would be open to the further objection that, under it, any heavy depreciation of sterling was likely to cause much dislocation in exchange and internal prices.

Moreover, the system would lack the simplicity which was premised as essential to secure public confidence. The mechanism of the exchange standard was too refined and the right of convertibility was too abstract and one of no direct concern to the general public for the existing conditions in India. The backing for the token currency was too intangible and invisible. Further, the suspicion in the public mind regarding the possibility of manipulation of the mechanism of an exchange standard to the detriment of Indian interests would be a fatal obstacle to the smooth working of that system. Indian public opinion would only have confidence in gold as a solid enough backing for the country's currency. It

[1] *Hilton-Young Commission Report*, par. 22 Sir James Begbie, dissenting from the majority of the Chamberlain Commission, had pointed out that the token rupee currency drove gold out of circulation and suggested that in order to induce the people to use their stored-up gold, an assurance that they would be paid back in gold was necessary—a view which was repeated by Mr (now Sir) Dadiba Dalal in his Dissenting Minute (par. 61) to the Babington Smith Committee's Report.

[2] Such a standard could be established by (i) amalgamating the Gold Standard and the Paper Currency Reserves by statute as a single currency reserve under the control of one currency authority and by (ii) requiring the currency authority by statute to sell rupees for sterling without limit at the upper gold point of a fixed parity and similarly by selling sterling for rupees at the lower gold point of the same fixed parity.

[3] A gold exchange standard could be secured by providing that the currency authority, instead of undertaking to buy and sell sterling (as under the sterling exchange standard) should undertake an obligation to buy and sell, at the upper and lower gold points respectively and to an unlimited extent, the currencies of any of the principal foreign countries with a gold standard. *Hilton-Young Commission Report*, par. 26.

required some link, not only real but conspicuously visible, between the currency of the country and gold. Thus the establishment of a true gold standard was indicated as the proper goal of Indian currency policy.

A Gold Standard for India

§8. **Finance Department's scheme.**[1]—Under a scheme for a gold currency standard submitted to the Commission by Sir Basil Blackett and other officials of the Finance Department of the Government of India, it was proposed that the silver rupee should cease to be legal tender except for small amounts, say up to Rs. 50, after a period of ten years, during which time it would be convertible into gold currency. The ideal ultimately to be reached was the system then in force in Great Britain under which the note was the sole full legal tender in circulation, and the gold value of the pound sterling was stabilized by the statutory obligation imposed upon the Bank of England to buy and sell gold at rates corresponding roughly to the par of exchange. We shall have to wait a long time, however, before conditions in India are so far changed that a full legal tender metallic currency will no longer be necessary. In the meanwhile, the attainment of such an ideal system would be expedited by expanding the ci.culation of notes by making them convertible into full-valued gold coins and not merely into over-valued silver rupees. In this way the hoarding habit of the people would be discouraged by assuring them that when they made investments, or deposits with banks, of a certain gold value they would get back the same in gold value. The proposed limitation of the legal tender quality of the rupee was intended to relieve the currency system from the consequences of any possible rise in the price of silver and to simplify the constitution of the reserves.

The Commission rejected the scheme on various grounds, their principal objections to it being that the large demand for gold by India would unsettle the world's currency and credit mechanism, and that the sale of the demonetized silver would have adverse reactions on the world's silver market and the silver hoards in India.[2]

§9. **The gold bullion standard.**—The Commission argued that it was possible to have a true gold standard without putting gold into circulation. They proposed 'that the ordinary medium of circulation in India should remain, as at present, the currency note and the silver rupee, and that the stability of the currency in

[1] See *Hilton-Young Commission Report,* vol. II, Appendixes 5-7.

[2] See *Hilton-Young Commission Report,* pars. 35-52.

terms of gold should be secured by making the currency directly convertible into gold for all purposes, but that gold should not circulate as money. It *must* not circulate at first and *need* not circulate ever'. (Par. 54.)

The chief reason, according to the Commission, against putting gold into circulation is that, the larger the amount of such gold in circulation, the smaller the gold reserves and the greater the inelasticity of the credit structure based on them. They endorsed the view of the Chamberlain Commission that gold in circulation is of doubtful value for the support of exchange. The Commission also urged that the gold bullion standard promised to set up almost immediately a full gold standard and dispensed with any period of transition contemplated in the other schemes. While providing for the gradual strengthening of the gold reserves at a rate which would not have any unsettling effects on world conditions, the scheme was capable of adjusting itself to any future decision in favour of a gold currency, which it was impossible to introduce all at once, but for which the door would be left open. The Commission's own view was that it would be unwise to contemplate the introduction of a gold currency under any conditions, and they expressed the hope that India would, in course of time, come to look upon it as an obsolete and outworn ideal. The War had taught the European nations to dispense with the expensive luxury of a gold currency. The restoration of the gold standard in England in 1925 had been effected without the reintroduction of gold into circulation, so that what was practically adopted was the gold bullion standard. In the United States also gold, which circulated in theory, did not circulate in practice. Indeed, according to some high authorities, gold in circulation was coming to be regarded as a sign of a backward civilization. Under the Commission's scheme the obligation to be imposed by statute on the currency authority was: to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold was required, so as to ensure the stability of the gold value of the rupee and the stability of exchange within the gold points corresponding to the selected parity. Gold was thus to be made the real standard of value. The rupee was to be linked to gold and not to sterling or any other currency or group of currencies. While the system was an absolute gold standard and not an exchange standard as hitherto, because rupees and notes were to be convertible into gold bars for *any* purpose, the compensatory mechanism of the exchanges was preserved, as gold bars are not currency. The currency would

be expanded when notes or rupees were issued by the currency authority in exchange for gold bars, and contracted when it gave gold bars for notes and rupees.

The conversion of rupees into gold bars and not coin, the demonetization of the sovereign (proposed in order that the existing hoards of gold coins might be prevented from entering into circulation) and the system of gold savings certificates (explained below in §11) would all tend to rob the hoards of their power of disturbing internal prices and money rates.

§10. **Buying and selling rates for gold.**—Buying and selling rates for gold, fixed with reference only to the par value of the rupee and without reference to the costs of importation or to any deviation in the value of the currency from its gold parity, would make the currency authority the cheapest market for gold. This would not only destroy the gold bullion market in India, but would also saddle the currency authority with the work of selling gold for non-monetary uses, which does not properly belong to it. In order to free it from this obligation, the Commission recommended that the selling prices of gold should be fixed at such rates as would make possible the replenishment of the stock of gold without loss by importation from London.[1]

The Commission proposed the removal of the legal tender quality of the sovereign so long as the amount of gold in the reserves was not big enough for the introduction of a gold currency, and so long as no definite decision in favour of a gold currency was taken. Otherwise, the gold from the reserves might pass into circulation, preventing any contraction in the currency and counteracting the compensatory effect of the exchanges.

§11. **Savings certificates payable in gold.**—As the obligation of the currency authority to buy and sell gold related to quantities of not less than 400 ounces of gold, it would be the bankers and bullion brokers who would make direct use of the provision and not the people at large. Therefore, to secure popular confidence

[1] The par value of the rupee as proposed by the Commission was 1*s*. 6*d*. (8·47 grains of fine gold) or Rs. 13·37 for £1. The par value of a tola of gold at this rate was Rs. 21-3-10. The Commission proposed as many as three different selling rates for gold, based on London as the gold centre for India: (i) When the T.T. rate on London was at or above the upper gold point (1*s*. 6 13/64*d*.), the selling rate for delivery in Bombay was to be the same as the buying rate, viz. Rs. 21-3-10 per tola of fine gold.

When the T.T. rate on London was below the upper gold point, the selling rate (ii) for delivery in London was to be Rs. 21-7-9 (allowing for cost of transport to London); (iii) while for delivery in Bombay it was to be Rs. 21-11-9 (allowing for twice the cost of transport). See *Hilton-Young Commission Report*, p. 95.

in the currency system, the Commission recommended that the Government should offer for sale savings certificates (in denominations of one tola and an integral number of tolas) redeemable in three or five years in legal tender money or gold at the option of the holder, and giving him an attractive yield in interest. This would of course involve the strengthening of the gold in the currency reserves. These certificates would stimulate investment, call forth hoards and supply a direct and visible proof that gold was the standard of value, and that the rupee and gold were mutually convertible one into the other.

§12. **Convertibility of notes.**—The Commission recommended that the existing anomaly in the Indian currency system due to the obligation of the Government to convert one form of note, namely the note printed on paper, into another form, namely the rupee, which is merely a note printed on silver, must be removed, to rid the system of the threat involved in a rise in the price of silver. Of course, the promise of converting the existing notes into rupees must be kept. But no obligation for conversion into silver rupees should attach to the new notes. It was, however, essential that facilities for the free exchange of notes for rupees should be provided, so long as the people desired to obtain metallic rupees, in order to inspire public confidence and ensure the popularity of the note issue.

The Commission proposed the re-issue of the one-rupee note with full legal tender power and, like the other notes of the new status, not legally convertible into silver rupees. This would help in popularizing the use of notes and offering a way out, in case the price of silver should ever again rise above the rupee-melting point.

In view of the withdrawal of the existing legal right of convertibility of notes into rupees, it was necessary to impose a statutory obligation on the currency authority to convert all notes, excepting the one-rupee note, on demand into legal tender money, that is, into notes of smaller denominations or silver rupees *at the option of the currency authority,* though all reasonable demands of the public for metallic currency should be met in practice.

§13. **Unification and composition of the reserves.**—The Commission recommended that the paper currency and gold standard reserves should be combined into one currency reserve so as to ensure the efficiency of its working and make it simpler and more intelligible to the public.

As regards the new reserve, the Commission recommended that: (i) The composition and proportion of the reserve should be laid down by statute so as to ensure automatic expansion and

contraction of currency and the compensatory effect of the exchange. (ii) The proportional reserve system should be adopted, and gold and gold securities should form not less than 40 per cent of the reserve. The currency authority should strive to work up to a reserve ratio of 50 to 60 per cent. The gold holding should be raised to 20 per cent of the reserve as soon as possible, and 25 per cent within ten years. During this period no favourable opportunity of fortifying the gold holding should be allowed to escape unutilized. Of the gold holding at least one-half should be held in India. (iii) The silver holding in the reserve should be very substantially reduced during a transitional period of ten years. (iv) The balance of the reserve should be held in self-liquidating trade bills and Government of India securities. The 'created securities' should be replaced by marketable securities within ten years. (v) Rs. 50 crores might be regarded as the approximate liability in respect of the contractibility of the rupee circulation. An amount equal to one-fifth of the face value of any increase or decrease in the number of silver rupees in issue should be added to or subtracted from this liability, and the balance of profit or loss should accrue to or be borne by the Government revenues.

The Commission urged that the fortification of the gold reserves in the manner described above would involve the minimum risk and expense and was necessary (i) to enable the currency authority to discharge its obligation to sell gold in exchange for currency and in view of the new status of the notes which were convertible into gold; (ii) to enable the Government to encash the gold certificates in case they proved to be popular; and (iii) to facilitate the introduction of a gold currency if it was decided to have it.

In the opinion of the Commission, silver reserves were out of place in a gold standard system, but the peculiar position of the rupee, due to the fact that it forms a large proportion of the total circulation, and the considerable seasonal ebb-and-flow in this form of currency, made it necessary to hold a part of the reserve in silver. The one-rupee note would reduce the quantity of rupees required, and therefore the silver holding in the reserve should be lessened in the period of transition, from Rs. 85 crores (on 30 April 1926), to Rs. 25 crores.

The Commission recommended that the rupee securities of the Government of India held in the reserves should be limited to an amount equal to so much of the circulation as was unlikely to be withdrawn, plus such further amount as could be easily realized without disturbing the Government's credit, because such securities are less desirable as assets than trade bills, which, unlike the former,

possess the quality of automatically expanding and contracting currency in accordance with the needs of the country, independently of the will and judgement of the currency authority. Moreover, a larger holding of Government securities would make their realization, in case of need, difficult. The new arrangements for the issue of paper currency and the position of the Currency Reserve since the establishment of the Reserve Bank of India (April, 1935) are reviewed in chapter x.

Gold Bullion versus Gold Currency Standard

§14. **Critique of the gold bullion standard.**—In the words of Sir Stanley Reed, 'the responsibility remitted to the (Hilton-Young) Commission was not the mere stabilization of the rupee, but the establishment of the standard which would command reasoned confidence in India, to link the rupee to that standard, and to provide for its satisfactory control, automatic working and stability; to bring the control of currency and credit under a single authority and to free the Indian currency and exchange system from the dominance of the silver market. In short, it was to establish the rule of law in place of the practice of administrative discretion '.[1] The Commission claimed for the gold bullion standard which they advocated that it made gold the sole standard of value and ensured the absolute convertibility of the internal currency into gold for all purposes, though it so arranged matters that, while gold was to be always available in exchange for currency in India, gold would remain in the central reserves for use in supporting the exchange value of the currency, but would not go into circulation.[2] The latter object was to be fulfilled by the demonetization of the sovereign and the sale by the currency authority of gold in the form of bars. Its purchase from the same authority by the public for non-currency purposes was to be guarded against by offering gold in quantities of not less than 400 ounces (or 1,065 tolas) at a time and at a rate inclusive of the cost of importing gold from London to Bombay.

The convertibility of legal tender currency into gold bars may be good enough for banks and bankers, but for the masses it is quite inadequate and unintelligible. Also the minimum limit of 400 ounces is excessive and impedes the convertibility into gold so much as to make it unreal. The demonetization of the sovereign and half-sovereign was widely criticized as a definitely retrograde step, since even under the exchange standard before the War, a

[1] See *Indian Year Book* (1927), p. 302.

[2] Sir Basil Blackett's speech at Delhi, 23 November 1926.

considerable number of sovereigns, estimated at £6,000,000, were in the hands of the public. Even in England, under the new currency arrangements of 1925, the sovereign was not demonetized.

§15. **Case for a gold currency standard in India.**—The Commission's scheme of the gold bullion standard was obviously influenced by the analogy of the English system. The restoration of the gold standard in the form of a bullion standard in England in 1925, it is said, marks a considerable advance in the world's currency evolution towards the ideal system of an international exchange standard as recommended by the Geneva Conference in 1922, under which the internal currency would consist of inconvertible paper, and gold would be available only for liquidating foreign debts. But what suits an advanced nation like England may not suit a backward country like India. The English people are far better educated and have a far greater confidence in the currency authority than the people in India. Also, in England, under the old system of a gold currency standard, there has been a great development of banking and investment habits among the people. In India, on the contrary, thanks to the vagaries of the gold exchange standard and of its official management, public confidence has been impaired and the hoarding habit has been encouraged. The people are inclined to look askance at 'refined and logical currency systems' and prefer the cruder but well-tried variety of gold standard. Moreover, the persistent refusal on the part of the authorities to satisfy the demand for a gold currency has added to the strength of the desire for it. Most people in India are incapable of going through the intellectual gymnastics required for grasping the conception of a gold rupee as equivalent to 8·4751 grains of gold. The Commission's proposal in regard to the certificates payable in gold bullion[1] is not likely to be entirely satisfactory for the purpose of demonstrating to the people the solidity of the gold basis.

The gold currency standard is by no means the last word in currency wisdom. It is obviously very expensive, and although it is preferable from the point of view of stability of prices to a gold exchange standard as we have known it in India, it does not provide complete immunity from undesirable price fluctuations. As the late Dr Cannan observed, 'to tie the purchasing power of money to that of a single metal, though that metal is a very fine one, which would be put to an immense number of uses if it were less scarce than it is, has been rightly described as an expedient fit only for a barbarous age'.[2] Many novel schemes promising a

[1] *Ante,* §11.

[2] See *Economic Journal,* June 1924, p. 161.

more perfect stability have been propounded since the time of Ricardo, and progress no doubt requires constant though cautious experimentation to test their practical utility, instead of merely allowing them to slumber ' in the dormitory of the understanding '. But it is generally believed that, before any such experiments can be tried with a reasonable chance of success, it is first necessary for all the countries to put themselves on a firm gold basis. ' When the golden thread runs between all the nations of the world '[1] it will be easier for them to introduce higher forms of currency regulation. The exact type of a gold standard to be adopted by any given country will of course depend on its special conditions. In India conditions in 1926 pointed to a gold standard with its usual concomitant of a gold currency. Under those conditions in India a gold currency could not be regarded as an unnecessary luxury or a mere matter of traditional etiquette associated with the gold standard. This is why almost all Indian witnesses, and some European witnesses of unquestioned competence, like Dr Cannan and Dr Gregory,[2] strongly urged on the Hilton-Young Commission the need for the adoption of a gold currency standard. Sir Basil Blackett himself expressed the view (in his Delhi speech) that, before India could think of any ideal system she would probably have to pass first through the stage of having gold coin available, into which all other forms of currency would be convertible at will. The simplicity and intelligibility, which the Commission admit as being indispensable requisites of any currency system that could be regarded as satisfactory for India, cannot be said to be the distinguishing features of the gold bullion standard as recommended by them.

§16. **Other objections to the Commission's proposals.**—The buying and selling rates of gold proposed by the Commission have also been subjected to unfavourable comment. The regulation of the rates in such a manner that the currency authority will buy gold when it is cheapest and sell it when it is dearest in the market will have the effect of making the buying and selling transactions rare in India. This applies especially to the sale of gold by the currency authority. The public will buy only when the purchase is necessary for export purposes. Further, the offer to sell gold at a more favourable rate in London than in Bombay, proposed by the Commission when exchange is below the upper gold point, would encourage, or perhaps is intended to encourage, the delivery of gold in London. This has been objected to as perpetuating one

[1] D. M. Mason, *Monetary Policy, 1914-28*, p. 108.

[2] See *Hilton-Young Commission Report*, Appendixes 80 and 81.

of the evils of the gold exchange standard.[1] In this connexion we may refer to the Commission's recommendation that 'of the (Reserve) bank's holding of gold coin or bullion, at least one-half shall be held in the bank's custody in India, while the remaining half may be held outside India in the custody of its branches or agencies or deposited in other banks earmarked for the bank's account. Gold in any mint or transit belonging to the bank shall be counted as part of its reserves' (par. 145). The large holding of gold securities recommended by the Commission means that our reserve to that extent will be invested abroad. In view of the suspicion and distrust which the practice of holding reserves in London has engendered, special care was necessary not to propose any arrangements which would involve the location of Indian money in London. Apart from the question of public confidence in currency matters, the transition from the gold bullion to the gold currency standard which the Commission are anxious not to impede, if the people should desire it, will be rendered difficult if large gold assets are held abroad in the form of securities.

Although we hold that India would have done well to have adopted the gold currency standard in 1926-7 we must admit that in view of the widespread breakdown of the gold standard since September 1931, the absence of the requisite conditions for the successful operation of this type of standard and its uncertain future, the thought of taking any immediate steps in the direction of a gold currency standard or even the gold bullion standard must for the moment be abandoned. Even if we succeed in evolving in the near future a moderately satisfactory gold bullion standard when world conditions are favourable for a return to the gold standard, we shall have reason to congratulate ourselves.

The Commission did a valuable service to India by recommending that the gold exchange standard, which had been the cause of so much discontent, should be definitely scrapped, and that the official control over currency and exchange should disappear utterly and for ever. But the unsatisfactory gold bullion standard, which they proposed as an effective remedy for all the evils of the gold exchange standard, has not excited any enthusiasm in the minds of the Indian people. A genuine type of gold bullion standard suited to Indian conditions would have been more acceptable failing the full-fledged gold currency standard at the time the Commission's recommendations were made (1926). The question of the monetary standard in operation in India today (1938) and the future standard of India are dealt with later in the chapter.

[1] See P. B. Junnarkar, *An Examination of the Currency Commission's Report*, p. 55.

Stabilization of the Rupee

§17. **Need for stabilization.**—The restoration of the gold standard in England and the recovery of sterling in terms of gold (April 1925), the return in the Dominions and other countries to a gold basis and the comparative stability attained by world prices seemed to the Commission to warrant the belief that the time was fully ripe for the stabilization of the rupee. In order to obviate all uncertainty regarding the future of the exchange as well as to put a stop to all discretionary variations in the rate of exchange, immediate stabilization was essential. It was also desired by an influential section of the public as early as September 1923[1] (when the rupee was very near *1s. 4d.* gold) for the sake of putting an end to the artificial situation created by the retention on the statute book of the fictitious *2s.* gold ratio.

§18. **The ratio of stabilization.**—The Commission recommended that the rupee should be stabilized in relation to gold at a rate corresponding to an exchange rate of *1s. 6d.* for the rupee, thus giving it the value of 8·47 grains of gold. They thought that at that rate prices in India had already attained a substantial measure of adjustment with those in the world at large, and that any change in it would mean a difficult period of adjustment and widespread economic disturbance. They argued as follows:

(i) During 18 months, from December 1922 to June 1924, while the rupee was worth about *1s. 3d.* gold, the rupee price level ranged round a mean of about 176.

(ii) In the succeeding year, while the rupee was rising to *1s. 6d.* gold, the rupee price level fell below 160. (The rupee had risen to about *1s. 6d.* gold by January, and was held within *1s. 6d.* gold points after the end of May 1925. From July 1924 to June 1925 the rupee price level fell from 179 to 157.)

(iii) Since June 1925, while the rupee had remained at about *1s. 6d.* gold, the rupee price level had ranged round a mean of about 158, and had begun to show a tendency to fall in sympathy with world prices.

The level of world gold prices had been approximately the same at the beginning of period (i), and at the end of period (ii), showing that during the period of change there was a mutual adjustment of prices and exchange, and that a substantial equilibrium had been attained about the middle of 1925 and maintained since.

The main contention of those who doubted the adjustment of prices to the *1s. 6d.* ratio was that it was not till June 1925 that

[1] *Ante*, p. 338.

the rupee had attained 1*s.* 6*d.* gold. Since then the rupee prices had been practically stable in relation to the world prices. Therefore adjustment had still to take place. The Commission retorted that although the rupee did not definitely reach 1*s.* 6*d.* gold till June 1925, it had, between July 1924 and January 1925, already traversed more than eighty per cent of its upward journey from 1*s.* 3*d.* to 1*s.* 6*d.* gold; and that before June 1925 there had already taken place a heavy fall in rupee prices in relation to world prices, which was the complement of the steep rise in exchange.

The steadiness of the exchange during the twelve months preceding also showed that the difference between external and internal prices had been adjusted.

The so-called manipulation by the Government in order to keep the exchange at the level of 1*s.* 6*d.* merely amounted to a normal addition of currency during the busy season and equally normal contraction at the end of it.

That there was no disequilibrium between internal and external prices was also indicated by the fact that neither exports nor imports were adversely affected.

§19. **Wages.**—The Commission argued that when exchange and prices have been steady over a considerable period, there is justification for assuming that wages are in adjustment unless there are clear indications to the contrary. The statistics of foreign trade appeared to strengthen the assumption. The depression in agriculture, pre-eminently India's greatest industry, was in no way due to lack of adjustment between agricultural wages and the exchange. With regard to the Government services, the increase in the value of the rupee to 1*s.* 6*d.* had enabled the Government to refuse increases of pay which it might otherwise have been difficult to resist. As to the manufacturing industries, in the jute mill industry in Bengal, the wages were in line with existing price levels and cost of living. The steel industry was suffering not so much from high wages as from the stress of foreign competition, stimulated in some cases, as for example in the case of imports from Belgium, by depreciating exchanges. In the cotton mill industry, wages were apparently still too high, for, whereas the index figure of wages of mill-hands was 231 (as compared with 100 in 1914), the index numbers of wholesale prices, retail food prices, and cost of living were only 150, 150, and 153 respectively. This indicated that either the pre-War rate of wages was too low or that the existing rate was excessive. However that might be, it was highly undesirable to produce a concealed reduction in wages by adopting the lower ratio, and in any case it was highly improbable that the desired equilibrium could be secured in this manner.

§20. **Effect on contracts.**—The Commission admitted that many of the current land revenue settlements had been made when exchange was at 1*s.* 4*d.*, but in view of the great rise in prices since 1914, the real incidence of land revenue, measured in terms of commodities, had been very materially lightened, and, therefore, the 1*s.* 6*d.* rate could not be regarded as constituting any great hardship. With regard to other long-term contracts, the Indian exchange had been more or less unstable during the previous eight or nine years, when it was never at or near 1*s.* 4*d.* for any length of time so as to admit of adjustment on the basis of the old rate, and contracts and arrangements concluded prior to 1918, and still in existence, did not bulk as largely in the economic life of the country as those concluded during the subsequent eight and a half years, during which period the exchange had been in a state of flux. In any case, after the prolonged disturbances which had taken place, it was impossible to do absolute justice to the long-term creditor and debtor by fixing on any particular rate of exchange.

§21. **Arguments for 1s. 4d. considered.**—As regards the contention that the 1*s.* 4*d.* rate is the 'natural' rate for the rupee, the Commission argued that the only rate which could be properly regarded as natural was the figure at which prices were in adjustment with the existing volume of currency and in equilibrium with external prices. And from this point of view 1*s.* 6*d.* appeared to them to be clearly the 'natural' rate in the existing circumstances. If, on the other hand, by natural rate was meant that rate which would establish itself in the absence of statutory enactment or executive action to anchor the rupee at a particular point, on this supposition there would be such extensive fluctuations in the rate of exchange in a country like India with its wide seasonal fluctuations of trade, that it would be impossible to distinguish any particular rate as 'natural'.

The argument that the 1*s.* 6*d.* rate had come into being through Government manipulation was in any case irrelevant. When prices and other conditions were in adjustment with those in the world at large on the basis of an existent exchange rate, the question of the means by which that rate had come into existence had no bearing on the extent or violence of the economic disturbances to be expected from an alteration in the rate.

Even if the view that prices and wages had been substantially adjusted to the 1*s.* 6*d.* rate were challenged, it could not be seriously contended that they were in any way adjusted to the rate of 1*s.* 4*d.* because that rate had never been effective sufficiently long during the preceding eight years or so. In so far as adjustment

had taken place at all, it must have been to the higher rate of 1*s*. 6*d*. The reversion to 1*s*. 4*d*. in these circumstances was bound to produce a general rise of prices to the extent of 12½ per cent, a change which would press severely on consumers in general and especially on the poorer paid members of the literate classes. It would also result in an arbitrary reduction of the real wages of labour for which there was no justification in equity or in expediency. The finances of the Government, Central as well as Provincial, would be seriously upset by a reversion to 1*s*. 4*d*., which would further postpone indefinitely the long and loudly called-for abolition of provincial contributions.

§22. **Minute of dissent.**—Sir Purshotamdas Thakurdas in his Minute of Dissent pointed out how the Government had made up their mind to raise the exchange to 1*s*. 6*d*. and had surprised the Commission with a *fait accompli* so as to prejudice both their inquiry and finding. He shows how the Government threw away the opportunity in September and October 1924 of stabilizing the rupee at the pre-War rate of 1*s*. 4*d*. and used the fictitious ratio of 2*s*. gold on the statute book as a potent weapon for rigging up the exchange—a procedure which involved serious contraction of currency.

His main conclusions were as follows:

(i) No adjustment in wages had taken place and none was likely without a struggle. (ii) Until adjustment was complete, the 1*s*. 6*d*. ratio presented the foreign manufacturer with an effective, though indirect, bounty of 12½ per cent, which would place a heavy strain on Indian industries. (iii) A change in the ratio would mean an additional burden of 12½ per cent on the large bulk of the debtor class who were mainly agriculturists. The debt being an old one of long standing, it was natural to assume that it was mostly contracted on a 1*s*. 4*d*. basis. (iv) The adverse effect on public finances of a reversion to 1*s*. 4*d*. had been exaggerated. As against the increased rupee expenditure in regard to sterling liabilities in England, there would be an increased customs revenue of Rs. 2·62 crores under 1*s*. 4*d*., increased receipts from income-tax owing to industries being spared the disturbance inseparable from 1*s*. 6*d*., and the avoidance of bounties, etc. to industries as cover against foreign competition. Moreover, whatever the advantage to the Govenment, it is paid for by the producer who has to accept so much less in rupees for his produce. (v) The adverse effects of 1*s*. 4*d*. on a small section (about 21 per cent) of the population consisting of the poorly paid members of the literate classes must be allowed less weight than the suffering which the higher ratio would entail in the case of the remaining 79 per cent of the total

population. As to labour, the existing rate of wages was sufficiently high to cover a possible rise in prices caused by the adoption of 1*s*. 4*d*. In any case there was the compensating advantage of a continuity of employment due to the fact that the lower ratio would ensure greater prosperity to industry and agriculture, while the higher ratio was sure to injure both. (vi) The pre-War ratio of 1*s*. 4*d*. was disturbed as a result of the War in common with the ratios of other countries of the world. But other countries had invariably striven to restore their pre-War ratios. Even if it were ganted that the disturbance involved in either case was equal, the decision should still be in favour of 1*s*. 4*d*.

§23. **The ratio controversy examined.**—The Majority Report and the Dissenting Minute together provided a complete armoury from which combatants on either side drew their weapons in the fierce controversy which raged round the question of the ratio. However plausible the arguments may look at first sight, on a closer scrutiny it is possible to detect several flaws in the reasoning employed by the advocates as well as the opponents of the new ratio.

(i) *Criticism of the Majority's arguments.*—The Majority begin by pointing out that the index numbers, on which they base their arguments regarding the price adjustments to the 1*s*. 6*d*. ratio, are by no means an infallible guide.[1] But by the time they finish their calculations based on these admittedly imperfect index numbers, they somehow succeed in attaining an absolute conviction that substantial adjustment had undoubtedly taken place, and they work themselves up to an almost apostolic fervour in favour of 1*s*. 6*d*., forgetful of their own warning about the unreliability of the index numbers. (Sir Purshotamdas also lays himself open to a similar criticism when, from the same statistical material as employed by the Majority, he obtains a precisely opposite conclusion and shows an equally unwarranted and unquestioning faith in the accuracy of his results.)

No statistical evidence is adduced by the Majority to show that agricultural wages were in adjustment. It is only as regards the jute industry that they are able to make a positive assertion that the wages were in correspondence with current prices and cost of living. But in the case of the important cotton industry they are compelled to admit a serious maladjustment between wages and prices. Not content with trying to show that the bulk of the contracts were short-term and therefore not affected by the new ratio, they go out of their way in attempting to prove that even in the case of the long-term contracts the 1*s*. 6*d*. rate did not constitute a

[1] See *Hilton-Young Commission Report*, pars. 178-9.

hardship, because, for example, in the case of the land revenue settlements, the real incidence of land revenue had been materially lightened owing to the very great rise in prices since 1914. They argue against the concealed reduction of the wages of the mill-hands by manipulation of exchange, and, for the sake of consistency, they should have regarded the concealed increase in the land revenue assessment as one of the valid points against the 1*s.* 6*d.* ratio.

From the fact that, beginning from the year 1917, for about eight and a half years, the rate was at or about 1*s.* 4*d.* only for a short period, they argue that the great bulk of the contractual obligations originated when conditions were based on the 1*s.* 6*d.* rate, or at all events after exchange had broken away from 1*s.* 4*d.*

But although conditions were in a state of flux during the eight or nine years referred to by the Commission, it is not unlikely that a considerable number of contracts were entered into on the basis of 1*s.* 4*d.* For it cannot be denied that this had come to be widely regarded as the permanent or natural ratio, having been in uninterrupted operation for the long pre-War period, between 1898 and 1914, and there was a general expectation that when the upheaval caused by the War had spent its force and conditions assumed their normal complexion, the pre-War ratio would again be restored. In par. 198 of the Report, the Majority may be said to admit the existence of such general expectation, since they refer the falling tendency of the exchange in April 1926 to public speculation on the possibility of a lower rate than 1*s.* 6*d.* being recommended by the Commission.

The Majority, while rightly admitting that the influence of the ratio on Government finances must not be regarded as a decisive factor, were nevertheless not able to resist the temptation of exploiting the argument for all it was worth and more. It is not contended that the effect on public finances should in no circumstances be considered. We have in fact already admitted, in supporting Government action in demonetizing silver in 1893, that the embarrassments and uncertainties besetting Government finance constituted a powerful argument for the closure of the mints to silver. But there was nothing to show in 1925 that the financial difficulties of the Government would have been so absolutely overwhelming under the ratio of 1*s.* 4*d.* as to necessitate drastic action of some kind. It has been suggested that when the Government adopted the 2*s.* gold ratio in 1920, they were primarily moved to do so by the financial reason. The impending constitutional changes and the separation of Imperial from Provincial finance which they involved meant that the Government of India could

no longer levy contributions on the Provinces as freely as they had been wont to do. The high exchange therefore appeared to them a godsend enabling them to balance their budget without courting popular discontent by raising taxation.[1] We have already dwelt on the disastrous consequences of the action taken by the Government on the Babington Smith Committee's Report.

The Majority objected to a reversion to 1*s*. 4*d*. on the ground that it would entail undeserved suffering for the poorer paid literate classes. Considering that these classes had suffered more than any others by the recent rise in prices and that much of the burden arising from the extension of the new policy of protection which had been recently initiated was sure to fall on them, it may be argued that there was *prima facie* a good case for any step tending to promote the interest of the middle and the lower middle classes. But the general rise of prices to the extent of 12½ per cent, feared by the Majority as certain to result from the reduction of the ratio to 1*s*. 4*d*., assumed what really had not been proved, namely, that prices had already completely adjusted themselves to 1*s*. 6*d*. Further, even taking complete adjustment for granted, there were reasons for hoping that the full rise of 12½ per cent would not have actually manifested itself because it would have been counteracted to some extent by the unmistakable tendency of the world prices to fall.

The strongest point made by the Majority was that the higher rate had enjoyed an unbroken existence for over a year and that therefore presumably a good deal of adjustment had already taken place. Even here, however, it may well be objected that the period of 'over a year' was not long enough for substantial adjustment, and that the presumption was against, rather than in favour of, such adjustment having taken place.[2]

(ii) *Critical examination of the case for* 1*s*. 4*d*.—It can equally well be shown that the champions of 1*s*. 4*d*. did not always use arguments which were entirely unexceptionable. For example, they laid much stress on the excessive deflation of currency indulged in by the Government in order to maintain the ratio at 1*s*. 6*d*. But if the deflation was as great as it was made out to be, it must have substantially brought down the general level of prices. To

[1] See Ambedkar, op. cit., pp. 207-8.

[2] In his Minute of Dissent (par. 80) Sir Purshotamdas Thakurdas has referred to the view of Mr J. M. Keynes that, in a country like the United Kingdom, about two years is the necessary period for readjustment to a ten per cent variation in exchange and that, if this is the case in a country the bulk of whose trade is external, the period required must be undoubtedly longer in a country like India whose internal trade is much greater in volume than her foreign trade.

admit a considerable fall of prices, however, was to admit a more or less complete adjustment to the higher ratio.

The opponents of the higher ratio dwelt on the increase in the burden of rural indebtedness caused by it, but they did not take into account certain compensating advantages accruing to the agriculturist from cheaper implements and, in general, a decreased cost of production. They also failed to take cognizance of the fact that a good deal of the agricultural debt is incurred in kind and not in money, and that part of it also consists of short-period obligations.[1]

By far the strongest argument in favour of the old ratio was that stabilization at 1*s.* 6*d.* appeared like wanton tampering with the standard of value. Even if we choose the most favourable ground for the advocates of 1*s.* 6*d.* and assume that economic disturbance would have been greater under 1*s.* 4*d.*, the evils proceeding from this disturbance would have been more readily acquiesced in by the people. As it was, the departure from the old ratio vastly increased the number of currency malcontents and presented critics of the Government with a fresh grievance, so that the new ratio has taken its rank along with the drain theory as an all-sufficient explanation for every conceivable evil.

The economic historian of the future will certainly not record the period that has passed since the new ratio was made effective as among the most prosperous in the annals of this country, and the fact that the country has been passing through very difficult times has added to the vehemence with which the Government's exchange policy is being attacked. It may be argued that industry and commerce would have been in an even worse plight, if the country had gone back to the old ratio. This, however, takes for granted that more than 50 per cent of the transition to the 1*s.* 6*d.* ratio had been accomplished, which is precisely what requires to be proved. We have already suggested above that the evidence adduced in support of the Commission's view that the major part of the adjustment was already over, when they began their deliberations, is far from convincing. We have gone further and argued that even if the reversion to 1*s.* 4*d.* had meant slightly greater disturbance—and this is the utmost that need be conceded by anyone impartially weighing all the evidence produced—it would have been worth while risking it for the sake of the old standard. It should, however, be quite clear that the longer the period during which the new rate[2] is maintained, the stronger the presumption that

[1] See Coyajee, *India's Currency, Exchange and Banking Problems*, p. 10.

[2] The new rate (1*s.* 6*d.*) was placed upon the statute book by the Indian Currency Act of March, 1927. See §26 below.

conditions have settled down to it in a preponderant degree and the weaker the case for restoring the old ratio. The fact that the new ratio has now been in operation for over eleven years must undoubtedly be regarded as investing it, rather than the old ratio, with the sanctity of a well-established standard.[1]

§24. **Subsequent developments of the ratio controversy (April 1927 to September 1931).**—In the year 1929, the machinery of world finance, commerce and industry was subjected to severe shock and disturbance, largely owing to the speculative boom in the United States and the measures taken by the American Federal Reserve Bank authorities to check its course. These authorities used their enormous power in order to restrict credit so as to make it difficult and expensive to borrow for purposes of speculation. The high rates of money which thus came to prevail attracted funds into that country from all over the world. Currency authorities in many other countries had to raise their bank rates in order to prevent an excessive outflow of money and to protect their exchanges. The attempt of the American authorities to deflate gradually so as to prevent sudden dislocation to trade and prices was unsuccessful. Crash followed crash on the New York Stock Exchange. Owing to the shock to commercial activity prices fell rapidly, and this tendency was aggravated by the heavy withdrawal of gold by France, Germany and some other European countries into their currency reserves. India was inevitably involved in the world-wide depression which was greatly aggravated by these happenings in the United States. The principal industries of India, namely jute, cotton and steel, were all in a bad way owing to the heavy fall in prices. The prices of agricultural produce and raw materials suffered most of all and the principal Indian exports of cotton, jute, coffee and groundnuts were badly hit.

Owing to the crisis which blew over from America, prices of securities collapsed throughout the world, and Indian securities shared the common fate. The natural nervousness of the investors in these circumstances showed itself in reluctance to invest and the phenomenon of the flight of capital from the rupee. This tendency was further emphasized by the strong political agitation in India and the resolutions of the Lahore Congress in December 1929 suggesting the possible repudiation by a national Government of debt obligations not incurred in the interests of India.

In these circumstances the Government found themselves compelled to take special financial measures to maintain the exchange at 1*s*. 6*d*., such as currency contraction, the issue of Treasury Bills

[1] See, however, §§27, 30 and 32 below.

to Exchange Banks and other purchasers so as to control credit in the interest of the firmness of exchange, raising the bank rate of the Imperial Bank of India, etc.

The opponents of the 1*s.* 6*d.* ratio argued that since so much management and manipulation was found necessary to maintain it till as late as 1931, with perhaps the exception of 1928, long after the new ratio was put upon the statute book (in March 1927), conditions had not become adjusted to it and it was still desirable to go back to the old ratio of 1*s.* 4*d.* Another circumstance interpreted as showing the unsuitability of the ratio was the difficulty experienced by the Government in securing the necessary sterling funds for remittance to London in the years 1929-30 and 1930-1. The requirements of the Secretary of State had, therefore, to be met by other means, such as transference from the Paper Currency Reserve to the Treasury balances of the Secretary of State in London against contraction of rupees in India, and heavy sterling borrowings in London. Between November 1930 and March 1931 the situation became even worse. Not only were the Government unable to purchase sterling, but they had actually to sell sterling to the extent of £5·6 millions to meet the demand that had arisen. Later again they had to sell Reverse Councils of the value of £14 million between June and 19 September 1931 in support of the rupee.

As against the suggestion that the remittance difficulties of the Government indicated the failure of the 1*s.* 6*d.* ratio it was pointed out that to expect the exchange to remain wholly unaffected under the extremely abnormal and unsettling conditions since 1929 was to expect too much. Apart from the repercussions of the New York crisis and the big drop in commodity prices, which continued in an aggravated form until September 1931, there were other factors which contributed to exchange weakness, such as the uncertainty of the political situation in India causing among other things a flight of capital from India, speculation in exchange based on the possibility of a reversion to 1*s.* 4*d.*, etc.[1]

With regard to the policy of currency contraction and raising the Bank Rate followed by the Government from time to time in recent years, the Government of India argued that they had done for their currency what Central Banks had been doing everywhere else. Only in India the position was often misunderstood because the Government were the currency authority.

It is impossible to single out the new ratio as a factor of prime importance in explanation of the slump during the world depression.

[1] *Report of the Controller of Currency*, 1929-30 and 1930-1.

Allowing for a certain necessary time-lag we should expect that any economic dislocation that may have been due to the ratio would have shown itself at its worst in the years nearest to the time when it was established and that it ought to be less and less serious as we travel further and further away from this point.

A radical change in circumstances may of course at any moment call for an alteration in the ratio, however thoroughly well adjusted it may have been at one time. And certain circumstances have arisen since England left the Gold Standard in September 1931 in view of which it is possible to contend that a reconsideration of the matter has again become necessary.[1] From a strictly *economic* point of view, however, the question can no longer be regarded as that of a choice between 1*s.* 6*d.* and 1*s.* 4*d.* A possible abandonment of the present ratio need not necessarily mean a reversion to the old ratio of 1*s.* 4*d.* We should be quite prepared to find that if a thorough and unbiassed review of the position indicates the necessity of changing the present ratio (namely 1*s.* 6*d.* sterling), it might also indicate some ratio other than 1*s.* 4*d.* as the most suitable in the altered circumstances.

§25. **The Government accept the Hilton-Young Commission Report.**—On 16 January 1927, the Government published three Bills embodying the Commission's recommendations. These were (i) a Bill to establish a gold standard currency for British India and constitute a Reserve Bank of India, (ii) a Bill to amend the Imperial Bank Act, 1920, and (iii) a Bill further to amend the Coinage Act of 1906 and the Paper Currency Act of 1923 for certain purposes, and to lay upon the Government certain obligations in regard to the purchase of gold and the sale of gold (later altered to sterling) exchange. The first two Bills will be referred to in our chapter on Banking. Here we are concerned with the third Bill which was moved in the Assembly by Sir Basil Blackett on 7 March 1927. The Finance Member explained the principle of the Currency Bill, which was that the time had arrived to stabilize the rupee and that the Bill proposed for the first time in Indian financial history to impose a statutory liability on the Currency Authority to maintain the rupee at the ratio thus fixed. Before the War there had been no statutory provision for preventing the rupee from falling below a fixed ratio of gold, so that the link between the rupee and gold was imperfect. Sir Basil Blackett pointed out that the Bill was no more than a transitional measure intended to be operative only during the period between its passing and the time when the Gold Standard and Reserve Bank Act should come into operation. The

[1] See §§27 and 32 below.

Bill was bitterly opposed at every stage, but finally passed by a narrow majority, with one or two minor amendments, after a great and memorable fight. The Council of State passed it without any amendment. The Indian Currency Bill thus became law and came into operation from 1 April 1927.

§26. **The Currency Act of March, 1927.**—The new Act established the ratio of 1*s*. 6*d*. by enacting that the Government would purchase gold in unlimited quantities at the Bombay Mint at the price of Rs. 21-3-10 per tola[1] of fine gold in the form of bars containing not less than 40 tolas (15 oz.). Holders of legal tender currency (silver rupees and paper notes) were entitled to obtain on application to the Controller of the Currency, Calcutta, or the Deputy Controller of the Currency, Bombay, either gold at the Bombay Mint or, at the option of the Government, sterling for immediate delivery in London, provided they demanded and paid for an amount of gold or sterling of not less value than 1,065 tolas (400 oz.) of fine gold at the rate of Rs. 21-3-10 per tola of fine gold.[2] Sterling was to be sold at the same price after allowing for the normal cost of transport from Bombay to London. A rate of 1*s*. $5\frac{49}{64}$ *d*. was notified as the Government selling rate for sterling to meet these obligations.[3] On 1 April 1927, when the Indian Currency Act of 1927 came into force, conditions attaching to the acceptance of gold at the Bombay mint were published.

By the same Act sovereigns and half-sovereigns ceased to be legal tender in India,[4] but an obligation was placed on the Government to receive these coins at all currency offices and treasuries at their bullion value reckoned at Rs. 21-3-10 per tola of fine gold, that is, Rs. 13-5-4 per full weight sovereign. In spite of the fact that these coins ceased to be legal tender there was an appreciable import of sovereigns into India. The Currency Act of 1927 established what may be called a Gold Bullion *cum* Sterling Exchange Standard in India. Since the Government had the option of giving sterling and not gold, strictly speaking the standard thus established was a Sterling Exchange Standard although in practice it worked as a Gold Exchange Standard until 20 September 1931, sterling till then being at par with gold. (See §27 below.) ' If the Government chose to exercise the other option open to them of offering gold in exchange for rupees, India would have had, in point of fact, if not in law, a gold standard. Thus the standard of 1927, though

[1] The parity of the exchange was thus 8·47 grains of fine gold per rupee.

[2] See Dr L. C. Jain: *Monetary Problems of India*, p. 34.

[3] *Report of the Controller of Currency*, 1926-7, p. 3.

[4] It may be pointed out here that the British Gold Standard Act of 1925 did not demonetize gold coins, although the right of free coinage was withdrawn.

a sterling exchange standard, was capable of becoming a gold standard, and certainly indicated that the gold standard was the ideal of the Government.'[1] The sterling exchange standard of 1927 was, of course, superior to the earlier exchange standard since it established a statutory gold parity for the rupee and imposed a statutory obligation on the Government to buy gold and sell gold or sterling at fixed rates. In other respects, however, it still had all those deficiencies which we have already pointed out (see §§1-6).

§27. **Divorce between sterling and gold and its reactions in India.**—The monetary standard established by the Act of 1927 did not have a fair chance of being converted into a genuine gold (bullion) standard owing to the dramatic developments which the world currency and exchange situation underwent in consequence of the breakdown of the gold standard in Great Britain and several other countries of the world. Great Britain left the gold standard with effect from 21 September 1931. This led to certain important and inevitable reactions on the Indian currency and exchange system. As we have already seen, the Currency Act of 1927 laid upon the currency authority, i.e. the Government, the obligation to buy gold, and sell gold or sterling at its option. The Government thus bought gold and sold sterling at the lower gold point until 19 September 1931. On the 20th came the announcement of Britain having gone off the gold standard. On the 21st the Governor-General promulgated an Ordinance suspending the operation of the obligation to sell gold or sterling, which was widely interpreted in India as implying that the Government were no longer prepared to hold the rupee on to any particular ratio. On the same day, however, the Secretary of State announced his decision to maintain the rupee at 1*s.* 6*d.* sterling. On 24 September the Governor-General promulgated yet another Ordinance, called the Gold and Sterling Sales Regulation Ordinance, repealing the previous one and thus technically restoring the provisions of the Currency Act of 1927 but seeking in practice to exercise an effective control over the sale of sterling, and thus introducing a controlled sterling exchange standard. Under the terms of the new Ordinance, sterling was to be sold not to all and sundry but only to recognized banks, which were expected to realize their responsibilities in the matter. It was to be sold at the rate previously in force, i.e. 1*s.* 5$\frac{49}{64}$*d.* per rupee, for financing normal trade requirements and contracts completed before 21 September, and for reasonable personal and domestic purposes. It was not to

[1] Jain, op. cit., p. 35.

be sold for financing imports of bullion or speculative exchange transactions. These precautions were taken in order to avoid undue strain on the Government's gold and sterling resources and to prevent the flight of capital from India. This control was to be exercised through the agency of the Imperial Bank. The rupee, being linked to sterling, inevitably shared in the depreciation and fluctuations of the latter in relation to gold and to currencies still based on gold, such as the dollar and the franc. The rise in the value of gold in terms of sterling as reflected in the sterling-dollar cross-rate meant a corresponding rise in its value in terms of rupees. The price of gold in the bullion market, which was Rs. 21-13-3 per tola towards the end of August 1931, rose to as much as Rs. 29-2-0 in December 1931.[1] The stimulus of high prices and partly also the prevailing economic distress in rural areas induced people to sell their gold. About Rs. 50 crores worth of gold was thus exported from India between the end of September 1931 and the end of February 1932. This enormous export of commercial gold had a favourable reaction on India's balance of trade. The supply of sterling created against the gold exports came to be in excess of the demand for it, and rendered restrictions on the sale of sterling by the Government superfluous. This enabled the Government to repeal the Gold and Sterling Sales Regulation Ordinance on 31 January 1932. Thus technically the Currency Act of 1927 was fully restored, but that did not make any difference in practice. The Secretary of State's declaration that the rupee should be maintained at 1*s.* 6*d.* sterling actually remained in force, and India's standard continued to be the sterling exchange standard. The present situation and the future monetary standard of India are dealt with below.[2]

This phase of the Government's currency and exchange policy has given rise to acute controversy. Apart from the resentment caused in the country by the fact that the Secretary of State had made a vital announcement of a new currency policy without consulting the Indian legislature, the criticism levelled against the Government falls under two heads: (i) the linking of the rupee to sterling at 1*s.* 6*d.* and (ii) the uncontrolled export of gold from India.

§28. **The linking of the rupee to sterling at 1s. 6d.**—The following are the main arguments advanced in support of the policy

[1] In subsequent years the price of gold rose still higher, being Rs. 36-13-3 per tola on 7 March 1935—the highest recorded price since the abandonment of the gold standard by Great Britain. *Annual Market Review* (Premchand Roychand & Sons), 1935, p. 80.

[2] See §§30-1 and 33.

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adopted by the Governnment. (i) The choice for the Government was between achieving comparative stability by linking the rupee with sterling and risking complete instability by allowing the rupee to drift, without any attempt to regulate its exchange value. The former of these alternatives was clearly to be preferred. (ii) Though the Hilton-Young Commission had voted against linking the rupee to sterling, this advice, though sound enough in normal times, could not be followed in an emergency situation such as this was. India had annually £32 million sterling obligations and a sterling loan of £15 millions was maturing early in 1932. The difficulties in raising the necessary funds for these purposes would have been almost insuperable unless the rupee was linked to sterling. Without a stable sterling rupee the Indian Budget would become a gamble in exchange. (iii) So long as India remained a debtor country the risk of leaving the rupee alone and thus taking a sudden leap into the unknown was much greater than in the case of creditor countries like England. (iv) India's trade with England and other countries on a sterling basis represented no inconsiderable proportion of her total international trade. It was, therefore, advisable, if possible, to secure a stable basis at least for this trade. (v) There would be a welcome, although temporary, stimulus to the export trade of India with the gold standard countries owing to the depreciation of the rupee in relation to gold. (vi) It did not lie in the mouth of those critics of the Government who were anxious to stabilize the rupee at a lower value than 1*s.* 6*d.* to complain when the rupee at the current cross-rate was worth considerably less than 1*s.* 4*d.* gold.

The main arguments on the other side were as follows: (i) By linking the rupee to sterling India was being made to share in the fluctuations of sterling, which reflect economic conditions in England and not in India. By leaving the rupee alone, on the other hand, there would also be instability no doubt but this would reflect conditions in India itself. India was thus deprived of the freedom to adopt a rate of exchange suitable to her own requirements in respect of foreign trade and the internal price level. (ii) Against the advantage to exports to gold standard countries like the U.S.A., we must put the disadvantage to imports from such countries, as also the fact that the linking of the rupee to sterling constituted a form of Imperial Preference granted to England. (iii) There was the danger that the Government's attempt to stabilize the rupee even at the lower gold value of 1*s.* 6*d.* might involve the dissipation of the remaining gold reserves of the country. (This danger was not however serious owing to the arrangements made by the Government to conserve them, such as the restrictions on

the sale of sterling to the public.) (iv) It was also argued, for example, by Mr (now Sir) R. K. Shanmukham Chetty in the Assembly, that one of the logical implications of the policy of linking the rupee to sterling was to bring the rupee automatically back to gold when conditions were propitious for the linking of sterling to gold, irrespective of the economic conditions in India. (It may be pointed out, however, that the preamble to the Reserve Bank of India Act of 1934 makes it clear that the sterling exchange standard is a provisional one pending the restoration of normal monetary conditions in the world, when the Reserve Bank is to put forward proposals for a permanent monetary standard for India.) (v) Finally it is argued that though the rupee has depreciated in terms of gold it has continued to be overvalued in sterling at 1*s*. 6*d*., while the yen and other currencies have been devaluated in sterling. India is thus placed at a disadvantage.

§29. **The export of gold from India.**—The Government have been criticized for allowing the free export of gold, which has reached enormous dimensions. The total amount of gold exported from India since Great Britain went off the gold standard in September 1931 was nearly Rs. 318 crores till 30 July 1938. This has been widely interpreted to mean the wastage of India's gold resources, the wreckage of the indigenous banking system, and a drain on the accumulated savings of generations. It has been pointed out that the adventitious aid of gold exports has concealed the overvaluation of the rupee at 1*s*. 6*d*. It is alleged that the uncontrolled export of gold makes it impossible for the country ever to reach the goal of the gold standard. It is feared that it will not be easy for India to buy back the gold she is now exporting on an unprecedented scale. It is further pointed out that almost every other country in the world is sitting tight on its gold and is trying to add to its stock of gold whenever possible. Finally, it is contended that the gold that is exported is 'distress gold', and that the people are living on their capital—a process which cannot continue indefinitely. There has been a good deal of agitation in the country in favour of either complete prohibition of the gold exports or the levy of an export duty. It has been further proposed that the Government (or the Reserve Bank of India) should themselves purchase this gold at a price regulated by the dollar- and franc-sterling cross-rates and thus strengthen their gold reserves.[1]

In support of the Government's policy,[2] however, it is argued

[1] cf. Sir M. Visvesvaraya, *Planned Economy for India*, p. 184.

[2] Sir James Grigg during the course of his Budget Speech (1935) expressed the Government's point of view as follows: 'I cannot share the views which attribute to gold exports some abstruse monetary significance

that the gold that is being sold is not currency gold but commercial gold, a commodity serving as a store of value. It is being sold because the owners are realizing a profit on it.[1] It is also being sold because many people are finding themselves compelled to turn their assets into ready cash for meeting their obligations. The fact that distress prevails is deplorable. But obviously the interest of the distressed person lies in unrestricted freedom being allowed to him in disposing of his gold in the dearest market. It should further be borne in mind that gold in the hands of private persons cannot be obtained by the Government for any purpose unless the price offered is sufficiently attractive to the owners. It is further argued that the gold that is being exported is only a fraction of the total store of gold in India, which had been estimated at £750 million.[2] As the price of gold falls, as it must eventually, the metal will be bought back again since there is no reason to suppose that the well-known hunger for gold of people in this country will disappear suddenly. In the meantime it is oiling the wheels of trade and helping productive enterprises. It has had a favourable effect on the balance of trade and has converted inert metal into live currency. It has produced a welcome effect also on the Government's financial position so far as the sterling remittances to the Secretary of State and the strengthening of the sterling reserves are concerned. Further it has seemed to keep the rupee-sterling exchange stable at 1*s*. 6*d*. and has greatly improved the position of India's credit in the city of London and the world. The exports of gold have brought about an increase in the note circulation, holdings of postal cash certificates, postal savings deposits and bank deposits, have generally created cheap money conditions in the money market and have assisted business recovery in the country.

The Government's offer to buy gold would mean that they would be speculating in gold, as the buying rate would have to be fixed

nor do I find in them an indication that India is being driven by distress to part with her last reserves. Indeed, I can see no sufficient reason for placing them in a different category from exports of any other commodity of which India has a surplus, and I, therefore, find no cause for regret or alarm in the fact that India is still able to obtain so handsome a profit from the reserves of gold which had been accumulated in previous years.'—*Central Budget for 1935-6*, par. 23.

[1] The present (August 1938) market price of gold in India is about Rs. 36 per tola.

[2] It has been suggested that to a debtor country like India with an annual bill abroad variously estimated at between Rs. 50 crores and Rs. 70 crores, a major portion of the gold imports in the past appear to be a luxury and represent a liability looking at them as an item in the balance of payments. Thus viewed, the existing outflow of gold could be regarded as a deferred squaring of accounts. *The Times of India*, 7 January 1936.

with reference to the fluctuating dollar-sterling and franc-sterling cross-rates. It can, indeed, be justly complained that the Government have failed to make the special effort that was expected of them to fortify their gold reserves in pursuance of the recommendations of the Hilton-Young Commission. This is, however, scarcely an opportune time for the Government to purchase gold. It would be best to wait for prices to come down and to be more stable. As regards the suggestion for a duty on gold export, as Sir James Grigg pointed out (1936) in the Assembly, the burden would fall on the ultimate seller of gold, who was the agriculturist. The Government should not try to restrict the free sale of gold unless there are very strong reasons to fear that the policy of non-intervention will come in the way of equipping the Reserve Bank of India with adequate gold reserves having regard to the country's present and future requirements. At the same time an intensive effort should be made to revive our export trade and to improve the favourable balance of trade.[1]

§30. **The present monetary standard in India.**—We have already pointed out how the rupee was linked to sterling in September 1931 and how the Indian monetary system came to be once again worked as a sterling exchange standard, although technically the Currency Act of March 1927 still remained on the statute book. The whole question of a suitable monetary standard and ratio once again became the storm-centre of an acute controversy in connexion with the nature of the exchange obligations to be imposed upon the proposed Reserve Bank of India. The London Committee on the Reserve Bank Legislation stated in its Report (August 1933): 'The questions which arise in connexion with the exchange obligations to be imposed on the Bank present special difficulty in existing circumstances. In the present state of monetary disorganization throughout the world, it is impossible to incorporate in the (Reserve Bank) Bill provisions which would be necessarily suitable when monetary systems generally have been re-cast and stabilized. In these circumstances we consider that the only sound course for India is to remain on the sterling standard. On this basis the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee-sterling ratio existing at the time when the Bill is introduced. This statement does not, however, imply any expression of opinion on the part of the Committee on the merits or demerits of the present ratio. The ratio provisions in the Bill are designed to make it clear that there will not be

[1] For a very illuminating discussion of the two sides of the gold export controversy in India see articles by Professor B. R. Shenoy and Professor B. P. Adarkar in the *Indian Journal of Economics*, July 1935, and January 1936.

any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act. . . . We are all agreed that it should, in any case, be made clear in the preamble (to the Act) that the whole question of the monetary standard best suited to India will have to be reviewed when the international situation has clarified itself and become sufficiently stable to make it possible to frame more permanent provisions' (par. 19). As the Committee themselves admitted, a considerable majority of Indian delegates felt it their duty to record their view that a suitable exchange ratio was one of the essential factors for the successful working of the Reserve Bank. They pointed out that considerable changes had occurred in the currency bases and policies of almost all the countries of the world in the last few years. In their view it was for the Government of India and the Legislature to examine these and all other relevant considerations with a view to ensuring that the minimum possible strain was placed on the currency system of India. Sir Purshotamdas Thakurdas in a separate note put forward a strong plea for the review of the ratio before the inauguration of the Reserve Bank and held up the example of Australia, New Zealand and the United States, who had devaluated their currencies with a view to raising prices and improving their balances of trade. He referred to the strong and strengthening opinion in India that a lowering of the existing ratio of 1*s*. 6*d*. would give much relief to the cultivator. There was a similar cleavage of opinion among the members of the Joint Select Committee to whom the Reserve Bank Bill was referred in September 1933. The majority approved of the London Committee's recommendation of continuing the *status quo* and leaving the question of permanent measures to the future. When the Reserve Bank Bill, as reported upon by the Select Committee, came before the Assembly in November 1933, several amendments relating to the ratio clauses were tabled by members. Those seeking to leave the rupee to itself were not moved. Mr Raju's amendment prescribing a ratio of 1*s*. 4*d*. failed, as did another amendment that the ratio to be maintained by the Bank should be given to it by the Governor-General subject to the vote of the Central Legislature. While the Bill was on the anvil of the Legislature a country-wide agitation against the 1*s*. 6*d*. ratio was carried on by the Indian Currency League.

§31. **The exchange obligations of the Reserve Bank of India as the new currency authority.**—The ratio clauses (40 and 41) as finally embodied in the Act (1934) gave effect to the recommendations of the Majority of the London Committee on Reserve Bank Legislation. The Reserve Bank is required to maintain the existing ratio

(1*s*. 6*d*. sterling) between fixed upper and lower points as though the rupee was on a gold basis. By clause 40, the Bank is required to sell sterling to any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras or Rangoon and pays the purchase price in legal tender currency, for immediate delivery in London, at a rate not below 1*s*. 5 49/64*d*. for a rupee. This provision is intended to prevent the rupee from falling below 1*s*. 5 49/64*d*., which corresponds to the lower point of the rupee (i.e. 1*s*. 6*d*. *minus* the cost of laying down in London this amount of sterling). On the other hand, clause 41 makes it necessary for the Bank to buy sterling from any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras or Rangoon, for immediate delivery in London, at a rate not higher than 1*s*. 6 3/16*d*. for a rupee, which corresponds to the upper point of the rupee (viz. 1*s*. 6*d*. *plus* the cost of importing this amount of sterling from London to Bombay). It has also been laid down that no person shall be entitled to demand to buy or sell an amount of sterling less than ten thousand pounds.

The Reserve Bank Act thus legalized the existing ratio and provisionally established in India a sterling exchange standard of an improved type, in so far as there is a definite statutory parity prescribed for the rupee and an obligation under law imposed upon the Reserve Bank to maintain the rupee at this parity. So also the two separate Currency Reserves have been abolished and the Reserve Bank of India has been appointed as the new currency authority to issue notes, hold the Currency Reserve and work the currency system, thus replacing the Government who had so far taken upon themselves monetary duties.[1] Nevertheless even this improved sterling exchange standard is open to some of the criticisms pointed out earlier in the chapter (§§1-6). The preamble to the Reserve Bank Act incorporates, however, the suggestion of the London Committee that the question of the monetary standard best suited to India should be considered when the international monetary situation had become sufficiently clear to make it possible to frame permanent measures. Clause 55 of the Act requires the Bank to report its views (in the contingency contemplated above) to the Governor-General-in-Council regarding a suitable permanent basis for the Indian monetary system and to frame measures for the future monetary standard of India.

§32. **Pros and cons of devaluation.**[2]—It is superfluous to add that this arrangement has failed to give satisfaction to the currency

[1] See ch. x.

[2] For a detailed and critical treatment of controversy regarding devaluation see B. N. Adarkar, *Devaluation of the Rupee* (1937).

critics of the Government and the advocates of devaluation among the ranks of the Indian business community. (See also §30.) For example, Mr Manu Subedar, President of the Indian Merchants Chamber and Bureau, Bombay, in welcoming Sir James Grigg, the Finance Member in August 1935, suggested a review of the ratio with a view to raising prices and giving relief to the cultivator. The Finance Member in his characteristic candid way replied that he would be no party to any 'monkeying' with the present ratio. While welcoming a healthy rise in the prices of primary products in India, he pointed out that the effect of a lowering of the ratio would be to leave agricultural prices where they were—or even to lower them—and to raise the prices of manufactured articles. Owing to the existing disparity between agricultural and other prices such a result would lead to a further worsening of the position of the cultivator. Apart from this, a lowering of the ratio would in the opinion of the Finance Member make the budgetary problems of India, already sufficiently difficult, quite insoluble. (The Budget surpluses of the last few years do not quite support this contention.) Moreover, cheap and plentiful money, which already exists and which is the normal and recognized means of raising prices, has in India tended to create unhealthy speculative conditions, and this seems to indicate that for an agricultural country cheap money is not in itself sufficient to raise prices. In the view of the Finance Member there was needed in addition a general agreement among the nations of the world to stabilize their currencies and to reduce the restraints upon international trade. The controversy regarding devaluation of the rupee flared up early in October 1936, owing to the reactions in India caused by the devaluation of the franc and the other currencies of the Gold bloc countries towards the end of September 1936. Advocates of devaluation raised the issue on the floor of the Legislative Assembly by moving a motion of adjournment on 8 October 1936, which was defeated by the casting vote of the Pesident.[1]

In favour of devaluation it was argued that a realignment of Indian currency was essential in view of the devaluation of the franc and other currencies, that the rupee was overvalued even at 1*s.* 6*d.* sterling, and that devaluation would not only raise prices of primary produce in India but also help her to revive her export trade and favourable trade balance, thus obviating the exports of gold. Devaluation of the rupee, it was pointed out, would give

[1] This motion moved by Mr A. Ayyangar related to the failure of the Government of India to revise the Indian currency and exchange policy in view of the devaluation of their currencies by France, Italy and other European countries. *Legislative Assembly Debates* (8 October 1936).

relief to the farmer debtor, would stimulate the industrial development of the country and generally assist business recovery.

On the other hand, Sir James Grigg and other opponents of devaluation argued that devaluation of her currency by India at that juncture would constitute a breach of the Tripartite monetary agreement (1936) signed by the U.K., the U.S.A., and France, and would adversely affect the prospects of world stabilization of currencies. India's action in devaluing the rupee would provoke retaliation elsewhere and revive the currency war. There was no need for devaluing the rupee further since it had already been devalued by about 40 per cent in relation to gold by being linked to sterling, enabling India to share in the economic recovery of the sterling area. The rupee could not be said to be overvalued since it did not show any of the symptoms of an overvalued currency, viz. budget deficits, high money rates, loss of gold from currency reserve, falling trade balances and deflation of currency: Devaluation of European currencies did not much affect India and in any case she was armed under the Indian Tariff Act (1894) to protect her industries against dumping caused by depreciation of foreign currencies. As regards the much-desired revival of our export trade, devaluation was likely to worsen the present situation by provoking retaliation. The real trouble lay in aggressive economic nationalism abroad and restrictions on trade, and therefore the proper solution was to promote international goodwill, peace and stabilization of currencies. Lastly, it was pointed out that it would be unwise for India to indulge in devaluation and thereby upset the delicate fabric of the Otto Niemeyer (Financial) Award on the eve of Provincial autonomy under the new constitution.

In recent months (April-August 1938) there has been a good deal of agitation in India for an alteration in the rupee ratio. The weakening of the exchange value of the rupee, as indicated by the reduction in the sterling purchase rate of the Reserve Bank of India following a decline in the visible trade balance, has served as an added plea for the revival of the devaluation movement. The Working Committee of the Indian National Congress has taken up the question and the several Provincial Congress Ministries are said to be preparing a case for a revision of the rupee ratio to be submitted in due course to the Central Government. The latter are opposed to any alteration in the present statutory ratio, and in a *communiqué* issued on 6 June 1938 declared that they were satisfied that the maintenance of the present value of the rupee was required in the interests of India and that the gold and sterling assets available for this purpose with the Reserve Bank (and the Government of India) were more than ample.

Nevertheless the movement for devaluation is gathering force and seven non-official members of the Central Legislative Assembly succeeded in securing a ballot for the discussion on 2 September 1938 of their resolutions demanding the appointment of a Committee to report on the whole question of the rupee ratio and to determine a permanent basis for the Indian monetary system.

§33. **Future monetary standard of India.**—The question of the future monetary standard of India is attended by a twofold uncertainty. In the first place, no one can say definitely when the international monetary situation will be sufficiently clarified to justify action on the part of the Reserve Bank of India being taken on the lines indicated in the Reserve Bank Act.

In the second place, there is today no consensus of opinion among the nations of the world as to the future monetary standard and no early possibility of an agreed measure of stabilization of world currencies.[1] While expert monetary opinion as expressed at the World Monetary and Economic Conference held in London in June 1933 appears to favour the restoration of the gold standard, it is widely realized that the present is not an opportune moment to do so. The hope of early world stabilization of currencies raised by the Tripartite Monetary Agreement of October 1936, has not so far been realized; and no one can safely predict when the requisite conditions for the successful operation of an international gold standard will be fulfilled. It is clear, therefore, that India cannot make up her mind today as to her future monetary standard and it will be necessary for her to mark time and wait upon future developments. The managed currency standard appears to be far too advanced a standard for India to adopt, although as the ultimate goal of her currency policy hardly any other better standard can be suggested. Subject to the restoration of reasonably normal world conditions, she must continue her quest for some suitable form of the gold standard and adopt it at the right psychological moment. Even those who uphold the existing sterling exchange standard in India are ready to admit that it is by no means an ideal standard as a permanent measure, the fundamental objection to it being that it makes a country's monetary system far too dependent upon the monetary policies of another country, when identical economic conditions in the two countries cannot be postulated. One thing amidst these uncertainties is clear, and that is that the Reserve Bank should spare no effort to build up and strengthen the country's gold (monetary) reserves, which are the one safe sheet-anchor of a currency system in the economic welter prevailing in the world.

[1] See L. L. B. Angas, *The Problem of the Foreign Exchange*, ch. xxi.

§34. **Purchase of sterling.**—When describing the mechanism of Council Drafts attention was called to the recently started practice of Government purchase of sterling, which must be regarded as an important modification of the Council Bill system.[1] We have also made passing references to the employment of this new method for arresting the rise of exchange beyond a certain desired level.[2] We may now conclude this chapter by a more detailed description of this new system, which was introduced in 1923-4. In that year, while the weekly sales of Council Bills continued as before, the sales of Intermediates at higher rates were stopped and were replaced by the purchase of sterling in India from banks and private financial houses willing to sell their sterling resources in London for rupees offered to them in India. These purchases were conducted by the Government through the agency of the Imperial Bank. The system was further extended in 1924-5, when the purchase of sterling was resorted to as the principal method of remittance, the weekly sale of Council Bills being started only when a steady and continuous demand for Council Bills manifested itself. During the year 1925-6 there was no sale of Council Bills, and the system of Council Drafts has since then been entirely superseded by the novel method of sterling purchases in India.[3] The Hilton-Young Commission recommended the purchase of sterling by competitive public tender and the publication of the weekly returns of remittances. Accordingly, since April 1927, the system of purchase in India by public tender has been inaugurated. Tenders are received on one day each week, usually on Wednesday, simultaneously in Calcutta, Bombay, Madras and Karachi, and particulars of the amounts allotted at each rate are published on the following day in each of these places. Between the days on which the tenders are received Intermediates are on offer at the offices of the Reserve Bank of India[4] at these places at a rate 1/32*d.* above the highest rate accepted on the previous day on which the tenders were received. The weekly returns of remittances are also published.

The function of sterling purchases and the responsibility for remittances to the Secretary of State have been transferred to the Reserve Bank of India with effect from 1 April 1935. As in the case of Council Bills, the system of sterling purchase enables the Reserve Bank to take advantage of a firm or rising exchange and also to prevent the appreciation of the rupee above the point fixed

[1] *Ante*, ch. vii, §23.

[2] *Ante*, ch. vii, §38.

[3] See McWatters, 'Historical Memorandum on Indian Currency', submitted to the Hilton-Young Commission.—*Report*, vol. II, p. 2.

[4] Formerly at the Imperial Bank.

by the Reserve Bank of India Act. (See §31.) The object underlying the new system is that the factors influencing the immediate course of exchange can be much more accurately and promptly judged in India and the purchases can be regulated much more satisfactorily with reference to the varying conditions of the market. The operations of Government remittances can be conducted so as to avoid violent fluctuations in the rate, with benefit both to trade and to the country in general. In the early part of 1924-5, as we have already seen, further rise of exchange was prevented by Government purchases of sterling when the exchange had reached *1s. 6d.* This method suits the Exchange Banks very well, as they can sell sterling to the Reserve Bank of India against their London balances, which are increased by their purchases of Export Bills in India, and thus immediately replenish their funds in this country.[1]

The disadvantages attendant upon this system are similar to those which were usually made a ground for criticizing the old Council Bills system. For example, it was possible for the Government, unless they took care to limit their purchases of sterling to their actual requirements, to increase their magnitude to such an extent as to prevent in a large measure the free flow of gold into India. Similarly, the rate of purchase could be regulated in such a manner as to produce the same effect. If the Government offered rupees at lower rates than the upper gold point, the flow of gold would be effectively diverted from India. The possibility of India submitting to all these disadvantages is now diminished owing to the transfer of sterling purchases to the Reserve Bank of India, which is expected to be more competent in these matters than a Department of the Government of India. Another disadvantage that has been pointed out relates to the sale of sterling in India by the public tender system, which places foreign centres dealing with India at a disadvantage. Under the old system, because the Council Bills were sold in London which was the world's financial centre, foreign countries could easily compete in the purchase of drafts on India. It is more difficult for the foreign demand for rupees to manifest itself equally effectively in India, and thus the Government may not be able to obtain the best possible price for the rupee.[2] On a balance the new machinery of purchase of sterling in India is undoubtedly an advance on the Council Bills system and is calculated to yield satisfactory results now that the Reserve Bank of India has taken charge of it.

[1] See ch. x, §§11, 12, and 14.

[2] cf. Ramachandra Rao, 'Purchase of Sterling', *Mysore Economic Journal*, June 1928.

CHAPTER IX

PRICES IN INDIA

§1. **Importance of the problem of prices.**—Problems connected with price movements are at once the most abstruse and the most important in the discussion of economic conditions in any country. The importance of understanding the nature and extent of price movements is clear from the fact that land revenue assessments are largely based on them in this country. Price changes have also been associated with the Government's currency policy in India, and the question whether they indicate increasing prosperity or the reverse has been the subject of endless and acrimonious debate. An attempt will, therefore, be made in this chapter to measure the price movements in India in recent years and to ascertain their significance.

The movements of prices in India began to attract notice in the early seventies of the last century owing to the depression of industry and trade in gold standard countries and the striking fall in the value of silver which began from about 1874. Towards the end of the nineteenth century, much controversy had arisen regarding the relative stability of prices under the different standards. The general impression was that prices had been much more stable in silver standard countries, like India, than in gold standard countries, and it was in order to test the validity of this impression that F. J. Atkinson worked out figures bearing on price movements in India since 1861 in his *Silver Prices in India from 1861.*[1] It is, however, since the opening years of the present century that discussions regarding the tendency of prices to rise continuously have figured prominently in Indian economic literature. There was a widespread feeling that the continued rise of prices urgently called for investigation, and it was held by the critics of the Government, supported by the late Mr Gokhale,[2] that the Government currency policy was largely responsible for the evil. In 1910, the Government of India decided to undertake an exhaustive inquiry into the subject and entrusted the task to a committee (Datta Committee). The Report of this Committee was issued along with the Resolution of the Government of India in October 1914. Before proceeding to deal with the findings of the Committee, we may say a few words regarding the general trend of prices before the year 1890, which

[1] See Vakil and Muranjan, op. cit., pp. 134-5.

[2] See *Speeches of G. K. Gokhale*, pp. 150-3.

was chosen by the Committee as the opening year of the period (1890-1912) which was the subject of their inquiry.

§2. **A bird's-eye view of price movements since 1861.**—The accompanying table indicates the general course of prices in India since 1861 with 1873 as the basic year.[1] The general index number is based on the wholesale prices of 39 articles (28 exported and 11 imported articles), except in the case of food grains, namely, jowar, bajra, barley, ragi and gram—wholesale prices of these articles not being available before 1897.

Year	General index number for 39 articles (unweighted)[2]	Weighted index number (100 articles) equated to 100 for 1873[3]	Year	General index number for 39 articles (unweighted)[2]	Weighted index number (100 articles) equated to 100 for 1873[3]
1861	90	93	1919	276	301
1865	107	109	1920	281	302
1870	102	107	1921	236	273
1875	94	96	1922	232	266
1880	104	109	1923	215	259
1885	87	106	1924	221	257
1890	100	117	1925	227	265
1895	104	120	1926	216	260
1900	116	143	1927	202	...
1905	110	135	1928	201	...
1910	122	150	1929	203	...
1913	143	182	1930	171	...
1914	147	187	1931	127	...
1915	152	182	1932	126	...
1916	184	185	1933	121	...
1917	196	186	1934	119	...
1918	225	215	1935	127	...
			1936	125	...

The Government index numbers, taken from the publication *Index Numbers of Indian Prices*, in columns two and five of the table are unweighted. The equal importance attached to the commodities prevent the index numbers from faithfully recording the nature and significance of the changes in the price level.[4] India is an agricultural country and her agricultural production, which accounts for the bulk of her total production, consists of a few staple

[1] The year 1873 was chosen as the basic year because of normal seasons and because it was since about that year that the depreciation of silver and the consequent depreciation of the rupee may be said to have started.

[2] See *Index Numbers of Indian Prices, 1861-1931* and its annual addenda. The weighted index numbers set out in the third and sixth columns of the above table were originally compiled by Mr F. J. Atkinson of the Indian Finance Department. The index numbers for the years subsequent to 1909 have been compiled by the Department of Statistics on the lines of his calculations. For further details see *Index Numbers of Indian Prices*, p. 22, Appendix C.

[3] ibid.

commodities like rice, wheat, cotton, jute, etc., while others are comparatively insignificant. Some articles like cotton cloth, cotton yarn, raw silk and coal have been allowed to exercise an undue influence upon the final result, and the whole series of prices is dominated by imported goods and those in direct competition with them.[1] As the all-India index number, with 1873 as the base, is out of date, reference is usually made to the figures for the Bombay and Calcutta wholesale price indices. (See §9.) The base year 1873 can no longer be regarded as suitable for comparison. So also the relative importance of commodities has very probably changed since the compilation of the series was first undertaken.

§3. **Period from 1861 to 1893.**—We indicate below the general character of the price movements between 1861 and 1893.[2]

(i) *Rising Prices* (1861-6).—The American Civil War led to a scarcity of cotton. The resulting high prices caused a great influx of specie into India and extensive coinage of silver, which was followed by a considerable rise of prices. This episode of high prices showed clearly for the first time the influence of external factors on the price level in India.

(ii) *Falling Prices* (1866-83).—Except for a sudden jump in the prices of foodstuffs between 1876 and 1879 owing to a great famine, prices were falling from 1866 to 1883. This general fall in the earlier years may be regarded as a reaction against the previous high prices, and in later years as a counterpart of the general downward movement of prices which began in western countries from about 1874. It has been attributed to the slackening in the production of gold, the adoption of the gold standard by countries previously on a silver standard basis, the arrest of the expansion of the silver currency owing to the closure of the mints to its free coinage, the slowing down of the development of banking and the growing volume of trade under the stimulus of a decrease in the freight charges, and improvements in the arts of production.[3]

(iii) *Rising Prices* (1883-93).—The fall in prices in India was arrested earlier than in the gold standard countries of the west, as a result of the depreciation of the rupee. It must be noted, however, that though silver began to depreciate in terms of gold roughly after 1874, the general increase in the production of commodities led to a fall of prices until about 1883. After 1885,

[1] See Vakil and Muranjan, op. cit., p. 140.

[2] For a study of the general course of prices from 1825 to 1907, see G. V. Joshi, *Writings and Speeches*, pp. 596-600, and from 1861-93, Vakil and Muranjan, op. cit., pp. 311-21.

[3] See Irving Fisher, *Purchasing Power of Money*, p. 142.

when the production of silver definitely outstripped the production of commodities, we enter upon an era of rising prices in India. This may be regarded as having continued right up to 1920, except for the brief interval 1893-9, when prices went down somewhat owing to the contraction of currency in India due to the closing of the mints, though the effect of this factor was a little obscured by the famines during this period. The rise in prices was the outcome mainly of the depreciation of silver and the heavy rupee coinage between 1881 and 1892. We have already described the causes of the depreciation of silver and explained how its demonetization by Germany and other European countries led to a heavy inflow of silver into India so long as the mints were open to its free coinage.

§4. **The Prices Enquiry Committee (prices during 1890-1912).—** The period covered by the Prices Enquiry Committee extended, as mentioned above, from 1890 to 1912, and the five years 1890-4 were taken as the base for comparing the price statistics relating to the later years. The base period was comparatively normal and free from the violent fluctuations witnessed subsequently as the result of the two severe famines at the close of the century.

Index numbers for India of the general average of rupee prices and gold prices for the years 1890-1912[1]

Year	Rupee prices	Gold prices	Year	Rupee prices	Gold prices
1890	97	113	1902	111	115
1891	98	106	1903	107	111
1892	103	100	1904	106	110
1893	102	96	1905	116	120
1894	100	85	1906	129	134
1895	101	89	1907	133	138
[2]1896	106	99	1908	143	147
[2]1897	121	120	1909	133	138
1898	106	109	1910	132	137
1899	104	108	1911	134	139
[2]1900	122	126	1912	141	147
1901	116	120			

Until 1898, when the gold value of the rupee attained stability at 1*s*. 4*d*., the rupee and the gold index numbers differ. Between 1890 and 1894 the gold price of silver declined steadily. While the rupee prices fluctuated within moderate limits, gold prices of commodities fell in those years steadily from a level of 113 to 85. The

[1] K. L. Datta, *Report on the Enquiry into the Rise of Prices in India* (1914), p. 29.

[2] Famine years.

steady fall in the gold value of the rupee was accompanied by a steady decline in the general (gold) price level. Between 1895 and 1897, when the exchange was rising rapidly, the rupee price level, as compared with the average for the quinquennium 1890-4, was higher than the level of the gold prices. After 1898, when the rupee became practically stable at 1*s*. 4*d*., the index numbers of gold and rupee prices moved, as might be expected, in the same direction, although the former were higher than the latter by 4 to 5 points.

Taking now the whole period 1890-1912, there was a general rise in prices throughout India, which was specially marked after 1905. The rise in prices was specially marked in the case of hides and skins, food grains (pulses and cereals), building materials, and oil-seeds, all of which rose 40 per cent or more above the level of the basic period. Cotton and jute rose about 33 and 31 per cent respectively, while other articles of food, metals, and other raw and manufactured articles rose by about 25 per cent. There was a moderate increase in country sugar; but, on the other hand, there was an appreciable decrease in the prices of tea and coffee, imported sugar, dyeing and tanning materials, especially indigo, coal, and shellac, as also a slight fall in the prices of other textiles.

The extent of the rise in prices was not the same all over India, being greatest in famine areas such as Bundelkhand, Berar, Sind, Agra Provinces (North and West), Punjab East, Punjab West, the Deccan, and South Madras. The rise was comparatively small in Assam, which is practically free from famine. At the ports, as in Bombay, Calcutta, Madras, Rangoon, etc., it was less than in most of the up-country circles. The rise in prices at the ports was smaller owing to the fact that they were less susceptible to fluctuations since they drew their supplies from a wider area. Also in the earlier years the prices at the ports had been generally higher so that an equal rise in prices would show a lower percentage of rise than in the up-country circles.

While, however, there were striking disparities between the price levels in good and bad years, the inter-circle and inter-district variations showed a tendency to diminish with the linking up of markets by the railways. There was a tendency towards an equalization of prices all over the country.

§5. **Comparison of the Indian with the world price level.**—The following table[1] shows the range of increase in prices in different countries arranged in descending order. It gives the average prices during the quinquennium 1907-11 as compared with the average of

[1] K. L. Datta, op. cit., p. 50.

the basic period and of the quinquennium 1894-8, when the lowest price level was reached everywhere except in India.

Country	Compared with 1890-4	Compared with 1894-8
India	40	40
Belgium	25	26
Germany	24	38
United States	20	38
Canada	19	31
Italy	14	24
Australia	13	20
France	12	26
United Kingdom	9	21
New Zealand	1	9

This table clearly shows that the rise in prices was greatest in India. The United States and Germany also showed a considerable rise. But this may be attributed to their heavy protective tariffs and the influence of industrial and commercial combinations—factors which were practically non-existent in India.

§6. **Causes of the pre-War rise of prices in India.**—The most controversial part of the Report of the Prices Enquiry Committee relates to the analysis of the causes of the specially high price level prevailing in India before the War. The Committee divide the causes into two classes, viz. (i) causes peculiar to India, and (ii) causes not confined to India, that is, world factors; though they recognize that the two sets of causes reacted on each other.

(i) *Causes peculiar to India.*—According to the Committee the causes peculiar to India were (*a*) shortage in supply of agricultural products and raw materials; (*b*) increase in the demand for these commodities; (*c*) development of railways and other communications in India, and the lowering of the direct and indirect costs of transport in India itself and between Indian ports and foreign countries; (*d*) improvement in the general monetary and banking facilities and increase of credit; and (*e*) increase in the volume of the circulating medium.

(ii) *World factors.*—The world factors were (*a*) shortage in the supply of and increase in the demand for staple commodities in the world's markets; (*b*) the increased gold supply from the world's mines; (*c*) the development of credit; (*d*) destructive wars, and increase of standing armies and navies in most of the western countries and the United States, diverting capital and labour into unproductive channels and causing an increased demand for many classes of commodities. India was switched on to the currency gauge of the rest of the world owing to her abandonment of

the silver standard in 1893, and no doubt she shared in the price fluctuations in the rest of the world owing to these causes. What we want to know, however, is why the price level rose higher in India than in other countries.

§7. **Examination of the alleged causes peculiar to India.**[1]—The Report puts down the rise of prices in India largely to the shortage in supply, particularly of food grains, owing to (i) the growth of cultivation not keeping pace with the growth of population; (ii) unseasonable rainfall; (iii) the substitution of non-food for food crops; (iv) the inferiority of the new lands taken up for cultivation, etc. The following table compares the growth of population with that of production of food grains and the extension of cultivation.

Index Numbers (Average of 1890-1 to 1894-5 = 100)

	Average of the quinquennium					
	1890-1 to 1894-5	1895-6 to 1899-1900	1900-1 to 1904-5	1905-6 to 1909-10	1910-11	1911-12
Population	100	101·6	103·7	105·7	107·8	108·4
Total area under cultivation	100	98	103	105	108	106
Area under food grains ...	100	96	101	102	106	103
Production of food grains.	100	98	105	99	113	109

Mr Datta concluded from this table that population had increased by a larger percentage during the period under inquiry than either the total area under cultivation, the area under food grains or the total production of food grains. During the same period also there was an increase in the external demand for Indian food grains. The increase in the internal demand was attributed by Mr Datta to a rise in the standard of living of large sections of the people, particularly those engaged in the cultivation of jute, cotton, oil-seeds and wheat. We have already noticed that the Government of India did not accept this conclusion[2] on the ground that Mr Datta's data were largely conjectural and uncertain, and argued that the area under cultivation generally, and that under food crops in particular, had kept pace with the growth of the population and that there was an improvement in the outturn owing to the extension of irrigation.[3] We may remark here that, even although the area under cultivation may have kept pace with the growth of the population, this does

[1] See H. L. Chablani, *Studies in Indian Currency and Exchange*, pp. 56-72.
[2] Vol. I, p. 80.
[3] See Resolution of the Government of India on the *Report on the Enquiry into the Rise of Prices in India* (1914), pars. 13-18.

not necessarily prove that there could be no rise in the prices of foodstuffs, because the lands that were newly brought under cultivation were presumably inferior to those already under cultivation, and consequently it would not be worth while cultivating them unless the prices were higher. The Government of India, however, were on firmer ground when they argued that there was an improved outturn from land owing to the growth of irrigational facilities.

The substitution of non-food crops for food crops which was advanced by the Committee as one of the causes of the increase in the prices of foodstuffs had not in reality occurred to such an extent as to produce an appreciable effect on food prices. In any case, if there was a real shortage of food crops the food prices alone would have been affected, whereas the phenomenon to be explained is the rise in general prices which required some cause or causes also general in scope. Mr Datta's whole treatment is vitiated by his failure to distinguish clearly between relative and general causes. Also he strays into the path of error by arguing as if the level of prices depended not on the relation between the volume of goods and that of the circulating media but on the former and the size of the population.[1] A general increase in the prosperity of all sections of the people, which Mr Datta regards as having been responsible for an increase in demand, appears to be *prima facie* improbable in the circumstances supposed. If the supply of food failed to increase in proportion to the population, this must mean widespread distress in a country like India, which does not import foodstuffs from abroad except to a negligible extent, and in which agriculture is practically the only occupation of the people. If there was a universal increase in the standard of comfort this would have caused an all-round increase in productive efficiency, which by itself, unless it was accompanied by a corresponding increase in currency, ought to have occasioned a fall and not a rise of prices.

The development of communications would, on the one hand, tend to raise prices by increasing the rapidity of the circulation of money even assuming that there was no increase in the quantity of money, and on the other hand, it would tend to depress prices by increasing the volume of transactions. There is no evidence that the latter tendency was such as to overbear the former. The chief effect of communications is to make prices uniform, so that they will be higher than before in some places and lower than before in others. But what we are seeking an explanation for is a universal rise everywhere. Mr Datta isolates the influence of credit from

[1] See Chablani, op. cit., p. 62.

that of metallic currency. He does not admit that the volume of metallic currency had increased more than the volume of business, but he thinks that there was a considerable growth of credit in India during the period under inquiry. As we shall show presently, his former assertion was incorrect. And as regards the latter there was no such development in banking and credit as would have been necessary to produce the actual rise in prices.[1]

As to the export of foodstuffs producing a rise in prices in India, the following considerations must be borne in mind. In the first place, the proportion of exports to total trade never exceeded 7 per cent during the period in question and therefore their effect could not have been very great. Moreover, prices were actually lowest in years when the exports were highest. In fact, it would be equally valid to argue that it was the prevalent low level of prices which was the cause of the increase in exports. Again, wheat (the principal article of food exported) constituted only 10 per cent of the total food produce in India, and the influence of the export of a part of this 10 per cent on the level of prices of foodstuffs in general cannot be regarded as anything but negligible.

Other alleged causes are rise in wages, the import of capital into India and the influence of dealers' monopolies. As regards the first, it was a relative cause because there was no evidence whatsoever that there was a universal rise in wages in the agricultural and manufacturing industries. In the second place, it is well known that prices rise first and then wages. As regards the import of foreign capital this is an inadequate cause, because in some years the interest paid by India balanced the capital sent to India. Similarly, with reference to the last of the causes mentioned, namely, dealers' monopolies, this was at best a relative cause and, in any case, not adequate.

§8. **Currency inflation the real cause.**—By a process of elimination we arrive at the conclusion that the inflation of currency—which in India could only mean metallic currency owing to the inconsiderable development of credit—was the main cause of the rise in prices.[2] The rupee being no more than a note printed on silver

[1] Read on this point Brij Narain, *Indian Economic Life*, pp. 170-4.

[2] Mrs Vera Anstey holds that Indian prices rose more than external prices because, before 1914, the world rise in prices was composed of a comparatively small increase in the prices of manufactured articles, which form the bulk of products of industrialized countries (and particularly of Indian imports), and a very rapid increase in prices of foodstuffs and raw materials, which form the bulk of Indian products (and particularly of Indian exports). See V. Anstey, *The Economic Development of India*, p. 450. However, for reasons advanced in §7 above, we are inclined to regard currency inflation as the principal cause.

and being inconvertible into gold, it was almost as easy to issue it to excess as inconvertible paper notes. Its supply depended wholly on the discretion of the Government, who had the monopoly of its issue. The Government often wrongly supposed that more rupees were necessary, when in fact they were not wanted, and proceeded to coin them. That on occasions excessive coinage did take place in this manner, for example in 1905-7, has been freely recognized even by Mr J. M. Keynes, one of the warmest admirers of the gold exchange standard in India, as the following passage in his book, *Indian Currency and Finance*, testifies:[1] 'The effects of heavy coinage are cumulative. The Indian authorities do not seem to have understood this. They were, to all appearances, influenced by the crude inductive argument that, because there was a heavy demand in 1905-6, it was likely that there would be an equally heavy demand in 1906-7; and, when there actually was a heavy demand in 1906-7; that this made it yet more likely that there would be a heavy demand in 1907-8. They framed their policy, that is to say, as though a community consumed currency with the same steady appetite with which some communities consume beer.'

The view that heavy coinage was mainly responsible for the rise in prices was voiced in the Imperial Legislative Council by the late Mr Gokhale in 1908 in the following words: 'The stock of rupees in existence in India before 1898 was estimated by Mr Harrison, the expert, at 130 crores. During the last ten years the Government have made a net addition to this stock of over 100 crores. . . . Such a sudden inflation is bound to result in a general rise in prices. . . . What is probably happening is this. The rupees issued by the Government in response to the demands of trade go into the interior and spread themselves among those from whom purchases are made. But they do not flow back quickly to centres of trade, or to banks, and thus new rupees have to be obtained for transactions for which the old rupees might have sufficed. Meanwhile, the melting of rupees having ceased (as a result of the token character of the rupee since the closing of the mints in 1893 and its artificial higher exchange value), every issue becomes a net addition to the volume of currency.'

Mr Datta argues that there was no redundancy of rupees as the volume of business increased more than the volume of metallic currency. But if the expansion of business was more rapid it is difficult to see why prices should have risen at all. Again, in measuring the expansion of the volume of business, Mr Datta is

[1] p. 134.

guilty of a serious error in that, instead of taking the physical quantities of goods handled in the way of trade, he takes their values in terms of money (inflated currency), thus showing an unduly high percentage of increase. While thus overstating the expansion in the volume of transactions, Mr Datta understates the additions to the currency by failing to take into account the sovereigns and half-sovereigns and the small silver coins in circulation.[1]

The results of the discussion of this subject by Professors Vakil and Muranjan are set out below.

Period 1899-1913

1899-1913 Rise in currency circulation	1899-1913 Rise in prices	1899-1903 to 1901-1913 Growth of goods
98·8 per cent	58·4 per cent	42·6 per cent

From these figures the authors conclude that, assuming world prices rose by approximately 25 per cent during this period, at least a quarter of the total addition to the currency from 1899 to 1913 must be held to be inflationary in character.[2]

There is a striking parallelism between the general index number of prices and the estimated total of the currency for each of the years between 1903 and 1907, as the following table shows.

Year	General index nos. of prices	Estimated total of currency on the 1st of April of each year	Year	General index nos. of prices	Estimated total of currency on the 1st of April of each year
1903	100	100	1906	131	127
1904	102	110	1907	140	136 143 (Dec. 1)
1905	112	115			

Mr Datta, however, suggests that the parallelism is purely accidental. He urges that the average net coinage was much less during the period (1892-3 to 1911-12) than during (1874-5 to 1892-3). But he forgets that during the first period much of the coin was

[1] See Chablani, op. cit., p. 62.

[2] Vakil and Muranjan, *Currency and Prices in India*, p. 333.

melted and there was scarcely any net addition to the currency from year to year, whereas during the second period melting ceased as one of the results of the closing of the mints, so that every rupee coined was a positive addition to the existing stock. Again, before 1893, the value of the rupee depended on the value of silver, and the latter depended on the changes in the supply of silver (assuming demand to remain constant). The annual additions to the supply by imports of silver were so small relatively to the total stock of silver in the country, that they could not cause any noticeable alteration in the value of the metal and therefore in the value of the rupee. But after 1893 the main factor determining the value of the rupee was the quantity of rupee coins (and not silver) in existence at any given time, and since the annual coinage added considerably to the number of rupees already in circulation, the effect on rupee prices was pronounced.[1]

Mr Datta argues that a redundancy of rupees persisting over any length of time would have caused an export of gold and a continued fall in exchange; and that as this effect was not visible the theory of inflation falls to the ground. He wrongly imagines, however, that the suggested effect on exchange can follow from high prices, only if the latter are brought about by inflation of currency. As a matter of fact, his objection, in so far as it is valid at all, is valid not merely against this or that particular alleged cause of the rise in prices, but against the phenomenon of higher prices in India than world prices. The phenomenon itself, however, could not be denied. In fact it formed the very *raison d'être* of Mr Datta's own inquiry.

§9. **Prices during and since the War.**—The pre-War tendency of prices to rise, which we have discussed so far, manifested itself in an unprecedented degree during the years 1914-20, especially during the latter part of this period, owing to conditions created by the War. The rise in prices was, however, smaller in India than in some other countries, especially in those that were directly engaged in the War, as will be seen from the table on p. 409.

The higher rise of prices abroad would normally have been corrected by a rise in exports and decline in imports. The consequent import of specie into India would have caused a rise in the internal prices until they equalled external prices. But the restrictions on the import of specie and exports of goods, as well as Government control of prices during War-time, prevented this adjustment. Indian producers were thus deprived of the benefits of higher prices.

[1] See Chablani, op. cit., pp. 67-8.

Index numbers of wholesale prices in India and some foreign countries

Year	(a) India (Calcutta) 1914=100	U.K. 1913=100 (Board of Trade)	(b) U.S.A.	France 1913=100	Japan 1914=100
1913	...	100	100	100	...
1914	100	100	98	102	100
1915	112	127	101	140	97
1916	128	160	127	188	117
1917	145	206	177	262	149
1918	178	226	194	339	196
1919	196	242	206	356	236
1920	201	295	226	509	259
1921	178	182	147	345	200
1922	176	159	149	327	196
1923	172	159	154	419	199
1924	173	166	150	489	207
1925	159	159	159	550	202
1926	148	148	100	703	179
1927	148	141	95	617	170
1928	145	140	97	620	171

This was one of the reasons why they were unable to build up ampler reserves and were at a disadvantage as compared with the importers of competitive articles, when the War-time boom was followed by a depression. Again, in the absence of Government interference, exchange would have risen even earlier and more rapidly than it did and this would have stimulated imports and checked the relatively greater rise in the price of imports. India would have received better value for her exports and would have been better able to meet the cost of post-War reconstruction. The consideration, however, which prompted Government interference with exchange was that serious trade dislocation would have resulted at a very critical stage of the War if exchange had been left to itself entirely.[1]

During the War period, the prices of practically all commodities in India, including the necessaries of life, showed a very steep rise. By 1919, the prices of food grains had risen on an average by 93 per cent since the commencement of the War, while the increase in piece-goods was just under 190 per cent for imported goods and just over 60 per cent for Indian-made goods. We have already observed that the prices of the imported goods, such as cotton

(a) See *Review of the Trade of India*, 1927-8 and *Report of the Controller of Currency*, 1927-8, Statement I.

(b) 1913=100 up to 1925, afterwards 1926=100.

[1] See Anstey, op. cit., pp. 457-8.

piece-goods, steel and iron, sugar, dye-stuffs, etc. in general, rose much more than those of the exported goods, and have also explained the causes of this disparity.[1] The diversion on the part of the principal nations of Europe of their energies to the work of destruction instead of production had naturally led to a world shortage of the necessaries of life. The shortage of production as well as the intense competitive demand of the belligerent countries for commodities of all kinds, together with the creation of a huge volume of credit and currency to finance the War, were responsible for the phenomenal increase of prices. These world conditions were bound, sooner or later, to react on India by increasing the demand for her products abroad as well as by adding to the cost of her imports. The restrictions imposed on exports by the shortage of tonnage and by Government control, however, checked the rise in prices in India to some extent.

§10. **Inflation of currency.**—We have already noticed that, for some time after the outbreak of the War, the balance of trade remained strongly in favour of India. At the same time there was a serious reduction in the imports of treasure, thus throwing upon the Government the whole of the responsibility of financing the export trade by issuing a large volume of additional currency in the form of rupees as well as currency notes. The expansion of currency of all kinds was very much greater relatively to the increase in the volume of business. The process of inflation was also helped by the methods of War finance adopted by the Government. In order to meet the heavy War expenditure they furnished themselves with the means of payment partly by raising taxation and loans and partly by the artificial creation of purchasing power. The Government possessing, as they did, the absolute monopoly of note issue, were able directly to provide themselves with the means of payment by watering the paper currency. The War loans of the Government also inevitably led to inflation. Only a portion of these loans came out of the real savings of the people. The remainder took the form of bank credits or the creation of deposits, subject to cheques, which the banks opened in favour of the Government, on their own account or on behalf of their customers who wished to invest in the War loans.[2] The short-term Treasury Bills which were issued by the Government of India for meeting the successive budget deficits were another source of inflation as the banks lent freely against their security and that of the War Bonds. Thus there was a very large increase in the bank deposits (credits) as well as in their velocity

[1] See above, ch. vi, §5.

[2] Panandikar, op. cit., pp. 317-18.

(as shown by the bank clearings),[1] which supplied so much more buying power and thereby contributed to the rise of prices.[2]

One of the causes why the rise of prices in India was not so high as in other countries was that the extent of currency inflation was far less in India, though speaking absolutely it was considerable. The inflation was accompanied by increased rapidity of circulation, proceeding from and reflecting a diminished level of public confidence, as in Germany and Russia, though here again the effect was on a very much smaller scale in India.[3]

There were other causes which aggravated the rise. Reference has already been made to the breakdown of the railway system and the shortage of rolling-stock during the War years. This led to difficulties in the distribution of goods and thus accentuated the effect of local scarcity, incidentally creating golden opportunities for the profiteer. Moreover, during the year 1918-19, there was a widespread failure of the monsoon in India, which caused a serious shortage of foodstuffs. There was again a failure of rains during the latter part of 1920 with similar consequences. Prices reached their highest limit in the year 1920 with the Calcutta index number at 201 as compared to 100 in 1914.

The influence of the 1*s.* 6*d.* ratio in *depressing* Indian prices has already been exhaustively dealt with and we need not say anything further here on that score.

§11. **Effects of high prices.**—The Prices Enquiry Committee held that the high prices in India before the War benefited the country as a whole. This view was then endorsed by the Government in their Resolution on the Report of the Committee (1914). The Committee argued that India, being a debtor country with large foreign obligations which she meets by the export of part of her produce, benefits when the prices of such produce rise, because then she is able to discharge her foreign obligations by the export of a smaller volume of commodities. But as against the high prices of exports we must set the increased prices of imports and the higher cost of production. In any case it is difficult to believe that a higher range of prices, especially when it is due to an inflation of currency, is by itself capable of conferring any permanent advantages on the country as a whole, sufficient to offset its well-known disadvantages. The late Hon'ble Mr G. V. Joshi expressed what after all is the sound view in this matter when he observed that 'a real increase of wealth and prosperity comes to nations as it does to individuals, not from any reckless piling up

[1] See also ch. x.

[2] See Findlay Shirras, op. cit., pp. 232 and 410-11.

[3] D. T. Jack, *Restoration of European Currencies*, p. 3.

of coined rupees or again from any rise of prices . . . which . . . in India is almost invariably associated with crop failures and famine conditions, but only from an increase in industrial activity, energy and efficiency on the one side, and on the other, from increased productive employment of capital '.[1] Rising prices do stimulate productive activity. But the process must be gradual and we can only know that it has been gradual if independent proof is forthcoming of the fact of increased prosperity. It is dangerous to suppose that if prices are rising, that in itself is sufficient proof that the nation is advancing in prosperity. For in that case material progress could be cheaply and effectively secured by deliberately raising the price level, say, by inflation. Mrs V. Anstey, in an interesting and thought-provoking chapter of her book, *The Economic Development of India*,[2] has attempted to derive certain conclusions regarding national prosperity from price- and wage-movements in India during the pre-War and post-War periods. She has argued that the results yielded by this method are more reliable than those based on the uncertain estimates of *per capita* income at various dates which we have discussed in chapter IV. It should, however, be noted that an examination of price changes cannot by itself give us any information as to whether there has been any progress or setback from the point of view of *wealth production*. It merely tells us in what manner the *distribution* of wealth amongst the various classes of people has been affected by any given alteration in the price level, and its conclusions as regards benefit or injury to the nation as a whole due to the price alterations are based on certain assumptions as to the relative importance to be attached to the welfare of the different classes. It is suggested, for example, that ' in India the bulk of the people belong to those classes which are benefited by a rise in prices ', and that the debtor classes are on the whole more deserving, so that even when they benefit at the expense of the creditor classes there is nothing to regret in this because these latter consist mainly of moneylenders who are simply ' bloodsuckers '. It seems, however, an invidious proceeding to classify certain sections of society as deserving and certain others as undeserving. A really sound notion of national progress implies the prosperity of all classes and not of some classes at the expense of others. Again, difficulty arises from the fact that many people are creditors at the same time that they are debtors. It also seems rather crude to indulge in sweeping

[1] See G. V. Joshi, *Speeches and Writings*, p. 610.
[2] pp. 445 *et. seq.*

condemnation of the whole creditor class. We have already seen how the moneylender is at present an indispensable member of the village community, and any general cause which injures him is likely to react unfavourably on the cultivator whose needs he supplies. There are indeed good reasons for supposing that the pre-War period between the years 1900 and 1914 was on the whole a period of steady if slow economic progress in India. But we contend that it is not possible to establish this conclusion by interpreting price statistics alone.

Mrs Anstey holds that the price changes before the War were of such a nature that they must at least have benefited the large body of cultivators in India; because the rise in the articles of export, that is those which the cultivator sells, for example jute (43 per cent), hides and skins (59 per cent), oil-seeds (45 per cent), food grains (42 per cent), was far more pronounced than the rise in the imports, that is articles which he purchases, for example cotton manufactures (25 per cent), metals (20 per cent), sugar (9 per cent), kerosene (no change), salt (which *fell* by 30 per cent even without allowing for the decrease in duty). A relative change in prices of this nature undoubtedly provides the conditions under which the cultivator may benefit, but there is no guarantee that the possible advantage will be always realized in practice. The profits of the cultivator are, for instance, liable to be intercepted by a variety of other interests, and special proof is required that this has not occurred to any considerable extent before we accept the advantage to the cultivator as established beyond doubt.

During the War, prices of imports rose more than the prices of exports. This had the result of increasing the expenditure of the cultivator relatively to his income, and is generally admitted to have injuriously affected the agricultural classes. Here then we have a refutation of the general proposition that a rise in prices must benefit the bulk of the people in India. Dr Mann's investigations, the results of which have been briefly set out below, actually show that the consequences of a rise in prices may be positively harmful. (See §14 below.) Monetary instability causes 'a re-distribution of the favours of fortune so as to frustrate design and disappoint expectation', and it destroys the atmosphere of security which is essential for the confident pursuit of economic activities. On these general grounds we must regard with suspicion any attempts to prove that large price fluctuations either in the one direction or the other are beneficial to the country as a whole.

With reference to the temporary advantages and disadvantages accruing from price fluctuations to particular sections of the

community, one part of the problem has already been dealt with in connexion with the ratio controversy. We had then occasion to describe how the different classes were affected by falling prices, and inferentially we may be said to have described the effects on them of a rise in prices also. All that is necessary for us now to do is to reverse the propositions laid down in connexion with the falling prices in order to get an idea of the adventitious gains and losses arising ~~from~~ rising prices.

However, it may be instructive to set forth more explicitly the consequences of price fluctuations in recent times in India and examine how different sections of the population have fared under them.

§12. **Effects on agriculturists.**—It is often said that landholders and the village people in general must necessarily benefit by high prices for agricultural produce. It is, however, clear that only those who have a surplus to sell would benefit, and only in case the goods they have to purchase have not also risen in the same proportion as the goods they sell. Again, as already stated above, the gains of the agriculturists in India are intercepted to a very large extent by a numerous class of middlemen, and the high prices consequently do not result in any appreciable advance in the economic condition of the agriculturist. We must also take into account the fact that, while cultivators of their own land and of lands rented on long leases, depending on their own labour and having a surplus to sell, stand to gain by high prices, this does not hold good of those who have to make rent payments in kind or who have received advances repayable in grain, or again those who hold short-term leases of land or have to employ hired labour. Moreover, both classes of cultivators have to reckon with increased expenses of production and higher prices of commodities like cloth, oil and other prime and conventional necessaries of life.

§13. **Rural labourers.**—It is almost axiomatic that wage movements lag behind price changes, so that when prices rise there is a shorter or longer period of hardship which wage-earners must generally go through. In this connexion it is necessary to bear in mind that many petty cultivators in India are also wage-earners. According to Mr Datta, however, the wages of rural labour—agricultural labourers and village artisans—rose faster before the War than the retail prices, and the rise was the greatest in rural areas, where the real wages of these classes showed an increase of 38 per cent.[1] Similarly, during the War and post-War period there was apparently a progressive adjustment of rural wages

[1] K. L. Datta, op. cit., p. 169.

to prices, established after an interval of considerable suffering during the period of non-adjustment. 'Throughout the period under review (1921-2) unskilled agricultural labourers commanded such high wages that in certain parts of India cultivators found a more certain and profitable means of livelihood than agricultural work.' The fall in prices since 1921 further secured to the rural labourer some increase of real wages.[1]

A downward tendency has, however, been noticeable in wages since 1926, especially in the rural areas. This tendency was accelerated during the years of the economic depression (1929-33). There was in these years a sharp fall in rural wages, although this was offset by the cheapness of foodstuffs and other necessaries of life (see §20 below).

§14. **Effects of high prices on rural prosperity in general.**— Dr Mann's conclusions with regard to the effects of high prices on rural prosperity in general are so instructive that we make no apology for reproducing his summary.

(i) (*a*) A 50 per cent rise in prices without a corresponding increase in wages makes for the advantage of those who have sufficient land which they work with their labour to maintain themselves in a sound position. (*b*) The man who benefits most is the non-cultivating proprietor who works his land by labourers. (*c*) Where there is a combined dependence upon the land worked by a family and upon income derived from the family's labour the final position depends solely on the proportion between the income from the self-worked land and that from labour. (*d*) But the general effect on the village population is disastrous; and the annual budget deficit among the families belonging to the village increases enormously.

(ii) If prices as well as wages rise, say, by 50 per cent, the people belonging to class (*a*) are again much better off. (*b*) The non-cultivating proprietor is not appreciably affected except in so far as he has large debts. The position of the people of class (*c*) is still improved and the improvement is slightly greater than the rise in prices. (*d*) The general effect on the village population is to lower their economic position.

(iii) With a rise of prices, whether wages increase or no, two general results seem to ensue. (*a*) The gulf between the solvent and insolvent of the villagers tends to widen, the vast majority of the people previously solvent becoming more so, while the position of the insolvents deteriorates. (*b*) On the other hand, since the rate of interest, which is always high in India, does not increase with the

[1] *India in 1921-2*, p. 103.

rise in prices, those who have incurred large debts previously suffer less in proportion than the others. On the whole, it may be said that a rise in prices tends to emphasize economic differences throughout the rural population in India, those who are well-to-do becoming more well-to-do and those who are poor becoming poorer.

It is true that the above conclusions do not pretend to be scientific generalizations of universal validity. They are merely intended to indicate the probable effects of a given rise in prices under conditions obtaining in the villages which formed the subject of Dr Mann's inquiry about the year 1917. We cannot say that a rise of prices must of necessity mean economic deterioration in India. But neither can we assert that it is necessarily beneficial, and this is the warning to be received from Dr Mann's study.

§15. **Effects on rent receivers.**—Regarding the effects of a rise in prices on cash rents, a distinction is necessary between protected or privileged, and unprotected classes of tenants. In the former case, illustrated by the class of occupancy tenants, rents would naturally show a comparatively small rise; while in the second case the increases might be very considerable.[1]

§16. **Effects on industry.**—(i) *Handicrafts.*—We have already drawn attention to the condition of economic stagnation of persons engaged in indigenous handicrafts owing to the competition of machine-made goods. The rise in prices, if anything, increased the severity of this competition and made the position of the handicraftsmen even weaker than before.

(ii) *Capitalist manufacturers.*—The case of capitalist manufacturers is more complicated, for, generally speaking, the rise in prices is not immediately followed by a proportionate rise in all the costs of production including wages. Therefore, *prima facie*, this class should benefit at least in the beginning. But, as will be shown below, the increased wages of the operatives in the manufacturing industries have in most cases exceeded the rise in prices. The fall in prices since 1920 has further increased the real wages of factory labour, and since no proportionate increase in efficiency is as yet in evidence, the manufacturers have on the whole suffered on the score of wages. The rise in prices during the War and the early post-War period no doubt brought the manufacturers immense profits, which would have been even higher but for Government interference. But these profits were mostly dissipated in the

[1] It may be noticed that in recent years there has been an attempt on the part of the labouring and tenant classes to secure for themselves the advantages of collective bargaining by the formation of tenant unions and *kisan sabhas*, not to speak of recent legislative interference on their behalf.

distribution of recklessly high dividends, instead of being utilized for strengthening the reserves. 'Full steam ahead and damn the consequences' seemed to be the motto of the mill-owners, and they are now paying the penalty for this policy. The difficulties of the present period of depression could not indeed have been avoided altogether by any amount of foresight, but the lack of foresight has certainly added to them to an appreciable extent.

§17. **Labour in rural areas and cities.**—In the pre-War period, as Mr K. L. Datta shows, the nominal and real wages of the different classes of labourers rose, though the rise in real wages was not so high as in the rural areas, being 38 per cent in the rural areas and 28 per cent in the cities. We have already traced the course of wages in the case of industrial labour during and after the War (with special reference to conditions in Bombay). The rapid rise of prices between 1917 and 1920 led to an epidemic of strikes, and in some cases there were even bread riots and looting of bazaars. After 1921, however, a definite improvement in the condition of industrial labour both by an increase of wages and a progressive fall in the cost of living, took place. But the adverse position of industry in the recent years of depression resulted in lower wages, widespread unemployment and much suffering among the wage-earning classes. A partial improvement is now (1938) in evidence.

§18. **Effects on persons with fixed incomes.**—The worst sufferers from high prices are persons with fixed money incomes, like pensioners, clerks and, in general, the lower grades of state and commercial employees, or those dependent on income from securities and shares, and professional men who live upon customary fees. These classes, collectively styled as the middle classes, suffer greatly during periods of high prices owing to their fixed money earnings and the heavy increase in the cost of food, clothing, lighting, house rents, and the wages of such labour as they happen to employ. Their social status debars them from undertaking work of certain kinds, while the market in which they themselves compete for employment is chronically overstocked. Nor have they yet learnt the value of organization and collective bargaining.

§19. **The latest phase: slump in prices.**—Prices in India having reached their maximum in 1920 began to decline from 1921, and for some time the process was more rapid in the United Kingdom than in India, endangering the Government policy of stabilizing the rupee at *2s.* gold. The sale of the Reverse Councils in 1920 and the consequent deflation of currency led to a fall of prices. Also, as a result of the adverse balance of trade in 1920-1 and 1921-2, there was an actual export of gold from India. Lastly,

there was the influence of world forces on Indian prices, explaining the striking parallel downward movement in India, the United States and the United Kingdom until 1929. (See Table on p. 409 above.) The influence of the 1*s.* 6*d.* ratio in depressing Indian prices has already been exhaustively dealt with and we need not say anything further here on that score.

The downward movement of prices was very appreciably accelerated after the Wall Street collapse in America (October 1929),[1] and is illustrated by the table on p. 419. It was a phenomenon from which no part of the civilized world escaped. The prices of primary products fell more than those of manufactured articles, and agricultural countries like India were more adversely affected thereby than industrial countries like the United Kingdom. An idea of the magnitude of the fall in India may be gathered from the statistics of the index numbers of prices in the table on p. 419. The Calcutta wholesale price index number (July 1914 = 100) stood at 143 in September 1929. In September 1931, when Great Britain went off the gold standard, the index number stood at 91 (i.e. below the pre-War level). The rupee, which was then linked to sterling, reacted to the immediate consequences of sterling's departure from gold, and the price level improved to 98 in December of the year. This advantage was not maintained in 1932, which saw a steady decline to lower levels, the index number falling to 88 in December 1932. In March 1933 it dropped to 83, but thereafter the price level steadied itself, and in December 1933 the index number stood at 89. January 1934 saw an improvement by one point which was lost in the succeeding month, while in March there was a further fall to 88. During 1934 and 1935 the price level generally fluctuated within a margin of two points from this level, the changes being more often in the upward direction. January 1935 was, however, an exceptional month and saw a sharp rise by six points from 88 in the preceding month. This advance was only temporary and was due to a speculative rise in the price of cereals and oil-seeds. From 87 in March 1935, the index number rose to 93 in December 1935. Thereafter there was a relapse, and in April 1936 the index stood at 90. Later there was a limited recovery and the year closed at 94. Prices had moved up by as much as 11 points by August 1937, when the Calcutta index stood at 105. This rise was caused partially by the world-wide rearmament campaign and prevalence of boom conditions and speculation. Since then the economic recession, which started in the United States of America, has had a depressing influence on

[1] *Ante*, ch. viii, §24. See also ch. vi, §7.

prices in India, as is shown by the decline of the Calcutta price index to 94 in April 1938.[1] A slight recovery is now in evidence, the July index showing a rise of one point.

It will be noticed from the table below that the price fall was greater in India than in the United Kingdom, Australia and Canada. In the U.S.A., after the disastrous fall of prices up to March 1933, a welcome improvement was noticeable before the recent recession. In April 1935 there was a gain of about 8 points in the wholesale price level in that country due to the devaluation of the dollar as well as to the operation of the N.R.A. (National Recovery Administration) and the Agricultural Adjustment Administration. In Japan, which left the gold standard in 1931, the trend has been definitely upward, especially from 1935. In France, which was the most important country in the gold bloc, the trend of prices was almost continuously downward, until the devaluation of the franc and virtual abandonment of the gold standard towards the end of September 1936. Since then prices have considerably advanced in that country. It will be noticed that prices in India have not advanced to the same extent as in other countries.

Index numbers of wholesale prices in Calcutta and Bombay and some foreign countries[2]

	India (Calcutta)		India (Bombay)[3]		United Kingdom (Board of Trade)	United States of America	Canada	Australia (Melbourne)	Japan	France
	July 1914 = 100	1929 = 100	July 1914 = 100	1929 = 100	1929 = 100					
1929 Average	141	100·0	145	100·0	100·0	100·0	100·0	100·0	100·0	100·0
1930 ,,	116	82·3	120	86·9	87·5	90·7	90·6	88·5	82·4	88·4
1931 ,,	96	68·1	109	75·2	76·8	76·6	75·4	79·2	69·6	80·0
1932 ,,	91	64·5	10[illegible]	75·2	74·9	68·0	69·8	78·3	73·3	68·2
1933 ,,	87	61·7	98	67·6	75·0	69·3	70·2	78·2	81·6	63·6
1934 ,,	89	63·1	95	65·5	77·1	78·7	74·9	81·6	80·8	60·0
1935 ,,	91	64·5	99	68·3	77·8	83·9	75·4	81·5	84·4	54·0
1936 ,,	91	64·5	96	66·2	82·7	84·8	78·0	85·6	89·9	65·5
Jan. 1937	98	69·5	104	71·7	90·1	90·1	85·0	91·2	106·1	85·8
Aug. ,,	105	...	106	...	98·0	92·0	...	...	107	...
Mar. 1938	96	...	100	...	91·0	84·0	...	...	114	...

[1] *Reserve Bank of India, Statistical Summary* (July, 1938), p. 6.

[2] *Report on Currency and Finance* (1937-8), Statement I.

[3] The table shows that the Bombay index number followed a more or less parallel course as compared with the Calcutta index number, but the increase in the Bombay index number after the middle of 1936 was greater, being nearly 10 points in March 1937.

One serious aspect of the price fall in India is the disparity in the price levels of raw materials and manufactured articles. This is shown by the index numbers of prices for exported articles, comprising mostly raw materials,[1] and for imported articles, consisting mostly of manufactured articles. As compared with September 1929, there was in December 1931 a fall of 39 per cent (according to the Calcutta index) in the case of the exported articles, while in the case of imported articles the fall was only 17 per cent. In recent years, especially since the middle of 1936 (when the prices of primary commodities recorded a considerable appreciation) however, there is a marked tendency for the prices of manufactured (imported) goods to adjust themselves more and more to the level of exported articles, as shown by the fact that the level of export prices was only 29 per cent below in March 1937, as compared with 25 per cent in the case of import prices (with 1929 as the base). Thus the difference between the two was reduced to four points.[2] This has had a beneficial effect on the economy of India, which is predominantly an agricultural and raw-material-producing country.

§20. **Causes and effects of the fall of prices.**—The causes of this world-wide fall in commodity prices were monetary as well as non-monetary.[3] The total world-production of gold until recently did not keep pace with the demand, and the position was aggravated by maldistribution of the available supply, most of which has been absorbed by the United States and France. This resulted in depleting the reserves of the central banks in other countries, forcing them to follow a policy of drastic deflation. The principal non-monetary cause was overproduction in comparison with the normal rate of consumption of raw materials as well as manufactured articles, but especially of raw materials. The political unrest in many parts of the globe, notably in India, China and South America, further aggravated the depression and fall in prices. We have already referred to the view that the overvaluation of the rupee at 1*s.* 6*d.* has depressed prices in India. This factor, to the extent to which it operated, applies to the earlier period of non-adjustment rather than to the later period. It is obvious that world factors are far more to blame than the internal causes.

The adverse effects of the fall in prices on the foreign trade of India and the balance of trade during the period 1929-30 to 1936-7

[1] The prices of agricultural staples like rice, wheat, jute, oil-seeds and cotton disastrously fell, especially in the years 1930-3.

[2] See *Review of the Trade of India* (1936-7), p. 22.

[3] See Paul Einzig, *The World Economic Crisis*, chs. vi and viii; and H. F. Fraser, *Great Britain and the Gold Standard*, ch. v.

have already been discussed (see ch. vi, §§7 and 16). The agriculturist has been hard hit because his receipts have dwindled owing to collapse of prices[1] while the incidence of his obligations in the shape of land revenue, rent, interest charges, etc., even when nominally unaltered, has become more and more onerous. This has seriously aggravated economic depression in the country by reducing the purchasing power of the agriculturist. It should be noted, however, that in spite of the fall in agricultural prices, our agricultural production did not contract as prices fell; in some cases even a tendency to increase in production was evident. In the Indian conditions, the agriculturist has to receive what price he can, and a vicious circle is set up whereby a decline in prices brings about some overproduction, and overproduction further depresses prices. The production of industrial raw materials like jute and rubber showed some amount of decrease. The economic blizzard also seriously affected public finance. Increased taxation, drastic retrenchment and deficit budgets sum up the effects of the fall in prices on finance.

The big drop in the purchasing power of the agriculturist and the heavy burden of taxation (e.g. the sharp increase in the income tax and the levy of surcharges) has adversely affected the position of industry and the volume of employment (see also chs. xi and xii) though the depression has not been so acutely felt there as in agriculture. During the last four years, however, there has been a limited economic recovery and India may be said to have passed through the worst of the crisis.[2] India like the rest of the world has experienced a certain amount of unwelcome 'recession', as is shown by the downward trend of prices of goods and securities and the lower level of industrial profits. But the recession itself seems now to be receding.[3]

[1] Taking the eight provinces (Burma, Bengal, Bihar and Orissa, Madras, Bombay, Punjab, United Provinces, Central Provinces and Berar) together there was a fall of 53·6 per cent in the money value of agricultural produce in 1933-4 as compared with 1928-9. During the same period the value of the total production of the principal crops in these eight provinces declined from Rs. 1,021 crores to Rs. 474 crores. This indicates the big set-back to the purchasing power of the agriculturist.

[2] For a detailed study of the course of trade depression and the effects of the fall in prices on India the reader is referred to Brij Narain, *India in the Crisis*; Sir J. C. Coyajee, *The World Economic Depression*; K. T. Shah, *World Depression*; and article on 'World Depression and India' by P. S. Narayan Prasad, in *Indian Journal of Economics*, October 1935.

[3] This was written in September 1938.

CHAPTER X

BANKING AND CREDIT[1]

§1. **Constituents of the Indian money market.**[2]—The money market and banking system of India comprise the following principal constituents: (i) The Reserve Bank of India; (ii) The Imperial Bank of India (originally the Presidency Banks); (iii) The Exchange Banks (mostly European or foreign); (iv) The Indian Joint-Stock Banks on European lines; (v) The Co-operative Banks; (vi) The numerous and heterogeneous group of indigenous bankers and brokers, called by different names in different parts of the country, such as Shroffs, Multanis, Banias, Marwaris, Sahukars, Mahajans, and Chetties, whose operations are almost entirely confined to the interior of India. The Indian money market is usually divided into two parts: (i) The Reserve Bank, the Imperial Bank, the Exchange Banks, and the Indian joint-stock banks constitute the central part, which may be called the European money market. (ii) The moneylenders and indigenous bankers, together with loan offices (in Bengal) and nidhis and chit funds (in Madras), constitute the bazaar part of the indigenous money market. The Co-operative Banks occupy an intermediate position. Bombay and Calcutta may be said to constitute the national money markets, as distinguished from a number of small local money markets in the up-country areas. The money market in India thus consists of numerous sections which are loosely related to each other, and offers a marked

[1] The most authoritative and exhaustive treatment of the subject of Indian banking and credit is now available in the Reports and volumes of evidence of the various Provincial Banking Enquiry Committees and of the Central Banking Enquiry Committee, appointed in 1929-30 in response to persistent public demand for a comprehensive inquiry. Before submitting its own Report the Central Banking Enquiry Committee had to take into consideration the Reports of the Provincial Committees. It had also to consider the views of the specially requisitioned body of six foreign experts. The foreign experts wrote a separate Report which has been included in the Central Committee's Report. The Central Committee's Report (1931) is often referred to in this chapter as *C.B.R.*, the numbers indicating the paragraphs.

[2] 'The term money market refers to the vast array of specializing institutions, such as the banks, stock exchanges, bill-brokers, acceptance houses, trust and finance companies and other specializing credit agencies whose main task is to supply the needed stock of money, be it State or Commodity money, or substitutes for the legal tender State money known as representative money or Bank money.'—B. Ramachandra Rau, *Banks and the Money Market*, Lecture I.

contrast with the highly organized and close-knit London money market. This subject is further discussed in §§25-8.

In addition to these main types, there are the Postal Savings Banks, the Land Mortgage Banks, which have recently come into existence, and the Stock Exchanges, at Bombay, Calcutta, Madras and Lahore.

History of Indian Banking

§2. **Indigenous banking.**—Indian banking is as ancient as Indian commerce. Perhaps India knew more about banking and knew it earlier than any other country in the world.[1] The *Arthashastra* of Chanakya (about 300 B.C.) describes powerful guilds of merchant bankers who received deposits, advanced loans, and, in short, carried on functions in many ways comparable to those of modern banks. Meadows Taylor in his *Student's Manual of the History of India* gives a flattering description of ancient Indian banking in the following words: 'The laws of Menoo disclose how thoroughly the science of banking was known 3,000 years ago. Then bankers understood and followed the fluctuations of money value: they kept account books, day-books and ledgers by single and double entry. They charged interest, simple and compound, they made insurances by sea and land, they granted bills of exchange, and in short they followed the practices of modern times which are little changed from ancient rules.'

The Mohammedan invasions of India initiated a period of disturbance and insecurity which were fatal to these old banking institutions. It was no longer safe for people to entrust to them their savings, which began consequently to be secreted in hoards. Individual bankers, however, continued to prosper and they usually combined commerce with banking. They advanced loans to the state, and many influential bankers' families were attached to one or other of the native courts. 'No royal court was complete without a state banker, who was often invested with the powers of a minister.' The history of the house of Jagat Seth, hereditary bankers of the Nabobs of Bengal, shows the important part played by these bankers in the politics of the country.[2] Even the East India Company had to rely on Indian bankers for loans and remittances, and they continued to wield a dominant influence as state

[1] 'From times immemorial the banker has been an indispensable pillar of Indian society. There is plenty of evidence to show that even prior to the advent of occidental ideas India was no stranger to the conception of banking.'—M. L. Tannan, *Banking Law and Practice in India*, p. 21. See also L. C. Jain, *Indigenous Banking in India*, pp. 3-16.

[2] See H. Sinha, *Early European Banking in India*, pp. 1-3.

financiers till the advent of the European Agency Houses. Besides the competition of these Agency Houses, towards the end of the eighteenth century several circumstances arose which were adverse to the continued prosperity of the indigenous bankers, for instance the establishment of European types of banks, such as the Presidency Banks, and the introduction of a uniform currency which hit the important money-changing part of their business. These bankers, however, managed to survive.

Even now the indigenous banking system plays a very important part in the monetary organization of the country. The Indian banker[1] is to be found in every village, town and city in the country. 'The type ranges from the small village capitalist to the wealthy well-established private partnership, generally a family partnership, of merchant bankers which has agencies in and outside India. A special type is that of the Chetty community in Madras, where there exists something approaching to joint responsibility of the community as a whole.'[2] The Nattukottai Chetties of the Madura District of Madras are especially famous as traders and bankers, and their operations are almost world-wide in their scope. The banking business carried on by Indian shroffs and money-lenders must be enormous in the aggregate. The general standard of business morality among Indian bankers has been universally recognized to be very high. Indigenous Indian banking is not organized on the joint-stock basis. Generally also there is comparatively little capital from deposits, and withdrawals against deposits are in cash and not by cheques. There is no share capital, and the liability is single or, in the case of a partnership, joint, and it is unlimited. The Indian banking firm or shroff generally combines trade with the business of finance.[3] Indian shroffs, unlike the English bankers of the eighteenth century, have never issued notes payable on demand, although legal prohibition to issue notes

[1] The Central Banking Enquiry Committee gave the following definition: 'By indigenous bankers is meant all bankers other than the Imperial Bank of India, Exchange Banks, the Joint-Stock Banks and Co-operative Societies, and the expression includes any individual or private firm receiving deposits and dealing in *hundis* or lending money.'—Par. 107. Those who do not receive deposits fall under other indigenous credit agencies (e.g. the village money-lender).

[2] M. S. M. Gubbay, *Indigenous Banking in India*, pp. 11-12.

[3] It has been suggested that this combination of functions is one of the reasons why Indian banking, having arrived at a certain high state of development, has not progressed further. The tendency to engage in other than purely banking business is on the increase because of the provision of modern banking and remittance facilities and also because of the extension of trade and industry. See L. C. Jain, op. cit., pp. 43-4.

did not exist for a long time. The great difference between modern banking on European lines and the indigenous banking system arises from the growth of joint-stock banks in modern times and the universal use of the cheque as a means of remittance through the mechanism of clearing houses. In times gone by, the principal business of the shroffs was to change money, a function which, as we have seen, was especially important when each petty state minted its own standard coin and the country was flooded with a large quantity of varied forms of metallic money. The shroffs also gave letters of credit, dealt in *hundis*, which are the indigenous analogue of cheques or internal bills of exchange, and occasionally helped the state in financing great undertakings.

§3. **Present position of indigenous banking.**—Even at the present time the shroff continues to play an important part in the financial system of the country as an indispensable link between the Indian money market and the vast trading community. He finances the agriculturist, the petty artisan and the small trader, assists in the movement of crops to consuming areas or to the ports, and distributes all kinds of goods in the interior of the country. He sends his agents with specie by rail, when necessary, in the harvest season, or he buys bills on Government Treasuries, and, when in need of funds, discounts his bills with the Imperial Bank or other banks in the commercial towns.[1] The indigenous bankers are in some ways formidable competitors to the big joint-stock banks organized on modern lines. As they pay a higher rate of interest they sometimes attract deposits more readily than the bigger banks. They also lend on personal security, and, in general terms, their requirements with regard to security are more easy to satisfy than in the case of banks. They are also at an advantage because under the present conditions the modern type of banks in India can never hope to get into sufficiently close touch with the affairs of the vast trading community all over the country to enable them to grant accommodation directly to more than a few of the bigger traders. The Indian bankers, therefore, are in existing circumstances indispensable middlemen. The Babington Smith Committee describes in the following words the manner in which the indigenous financial agency comes into contact with the modern monetary organization: 'The people with whom the banks deal directly are for the most part large shroffs of good standing in the principal cities. These men operate with their own capital, and generally speaking, it is only when they have laid out all their available capital in purchasing the *hundis* of other and usually

[1] See Shirras, *Indian Finance and Banking*, p. 241.

smaller shroffs that they come to the Presidency Banks. The shroffs, whose *hundis* the larger shroffs have purchased, have probably also similarly financed other and still smaller shroffs or *mahajans*, and so on, until we get down to the smallest flea of all, namely the village *bania* or grain-dealer or goldsmith. For instance, shroff A at Amritsar may purchase a bill drawn by a larger shroff at Lahore, who sells it to the Presidency Bank, which sends it to their Bombay agency for collection, or the bill may be a pure finance bill generally known as a hand bill as opposed to a "trade" bill, drawn against produce.'[1]

The growth of modern banking has not materially affected the business of the shroff. On the other hand, he has good reason to welcome it as relieving him of much inconvenience, for example, as regards sending specie and obtaining accommodation. He buys the *hundis* drawn by the trading community, charging them a rate of discount above the bank rate, the difference constituting his profit.[2] Though some of the indigenous private banking firms are being converted into private banks conducted on modern lines and issuing cheques, most of them still follow their old traditional methods.

§4. **Need for co-ordination between the old and new banking systems.**—It is generally recognized that in order to mobilize effectively the capital resources of the country as well as to establish any kind of unitary control over its credit organization, the indigenous banking system must be brought into an organic relationship with the new joint-stock system. As Sir George Schuster pointed out in the course of his remarks on the Reserve Bank Bill (1933) in the Assembly: 'It is impossible to over-estimate the importance of the part that the indigenous banker plays in the whole of the banking and credit machinery of India. I think it will be no exaggeration to say that his part of the organization represents, if anything, more than 90 per cent of the whole; and it is unfortunately true that the links between the whole of this system and the modern banking system of India, in spite of the development of rural co-operative societies and in spite of the opening of

[1] *Hundis* are drawn to serve three distinct purposes: (i) for raising a loan (here the *hundi* corresponds to the finance bill or hand bill); (ii) for financing trade, when it corresponds to a bill of exchange (but *hundis*, unlike bills of exchange, are not always accompanied by documents of title like sale contracts, invoices, and warehouse receipts, and are usually without them); (iii) for remittance of money from one place to another, whether for purposes of trade or otherwise.

[2] The bazaar *hundi* rate of discount is as a rule 2 or 3 per cent above the bank rate in Calcutta, and about 1½ per cent in Bombay, where the competition amongst the shroffs is unusually keen.

one hundred new branches by the Imperial Bank of India, are still rudimentary and incomplete. . . . Until the vast portion of India's banking and credit machinery, which is represented by the indigenous bankers, is put into gear with the relatively small machine of the modernized money market, with the Reserve Bank as its central control, it will be impossible for the Reserve Bank to exercise full control of currency and credit of India, which is understood as the function of a Central Bank in western countries; and it will be equally impossible for the masses of the people who populate the countryside of India to get the full benefits of credit and banking facilities on reasonable terms, which a well-organized system of banking ought to give.'

The Central Banking Enquiry Committee made a series of valuable recommendations with a view to bringing about a better co-ordination of the indigenous banking system with the general and especially the central banking organization of the country. They favoured the direct linking of the indigenous bankers with the Reserve Bank of India when the latter was established. They suggested certain conditions for the inclusion in its approved list of indigenous bankers, such as the limitation of their business to banking proper, having a certain suitable standard of owned capital (which should be lower than in the case of joint-stock banks), maintaining of account books in the usual manner and having them audited annually by recognized auditors and making them available to the Reserve Bank for inspection and audit. Such bankers should, however, be exempted from the rule relating to compulsory deposits with the Reserve Bank (applicable to joint-stock banks) during the first five years of the working of the Reserve Bank, provided their deposits do not exceed five times their capital. Indigenous bankers scheduled to the Reserve Bank were to be given certain privileges, the principal ones being the rediscounting of their commercial paper by the Reserve Bank, remittance of funds at the same rates as are charged to all joint-stock banks and extension of the benefits of the Bankers' Books Evidence Act.[1] (Pars. 139-42.)

[1] The Central Banking Enquiry Committee made certain other recommendations regarding the indigenous bankers, for instance, that the Reserve Bank and the joint-stock banks should use such bankers as their agents for the collection of cheques and bills in the same manner as in the case of banks, that indigenous bankers on the approved list of the Reserve Bank should be allowed to affix against their names the designation 'Member of the Central Bankers' Association' when the latter was established, etc. They did not, however, favour compulsory licensing of indigenous bankers, being apprehensive that compulsory licensing would scare them away and discourage them from following banking pursuits. *C.B.R.*, 138 and 145.

It was hoped when the Reserve Bank of India Bill (1933) was on the anvil of the Legislature that provision would be made in the Bill to implement the recommendations of the Central Banking Enquiry Committee. Great disappointment was felt in the country when no such provision was made, its omission being justified on the ground that the Government could not tackle the problem immediately, though they felt that some action was necessary. Accordingly a statutory obligation was imposed on the Reserve Bank under clause 55(1)(a) of the Reserve Bank of India Act (1934) to present a 'report at the earliest practicable date and in any case within three years to the Governor-General-in-Council with proposals, if it thinks fit, for legislation on the extension of the provisions of this Act relating to scheduled banks[1] to persons and firms not being scheduled banks engaged in British India in the business of banking'.

§5. **Reserve Bank's scheme of linking indigenous bankers.**—In connexion with this obligation the Reserve Bank addressed a circular letter to all scheduled banks and representative indigenous bankers on 6 May 1937 with a view to eliciting their opinion on the possibilities of linking the indigenous banker with the Reserve Bank. In view of their great numbers and the highly personal and fluid character of their business, the Reserve Bank proposed to deal with the shroffs through some intermediate agency, e.g. scheduled banks, which would share the financial responsibility and undertake the detailed examination which was necessary if credit was to be accorded. Under this provisional scheme the shroffs were to get their bills and notes discounted with the scheduled banks, which in their turn were to be enabled to get these documents rediscounted with the Reserve Bank. At the same time, the Reserve Bank indicated the conditions subject to which it was prepared to establish a direct link with itself. Among other conditions, the indigenous bankers were required to organize themselves into self-contained legal entities with at least Rs. 5 lakhs of their own capital (as in the case of scheduled banks), to maintain the same deposits with the Reserve Bank as the scheduled banks, to segregate their banking from non-banking business, and to maintain properly audited accounts.

This provisional scheme, which preferred indirect linking and laid down very stringent conditions for direct linking, raised a storm of protest. It was alleged that the Bank had exaggerated the difficulties of direct linking and had disregarded the recommendations of the Central Banking Enquiry Committee and the

[1] See §55 below.

wishes of the Central Legislature. In the light of the replies received from the Shroffs' Association and commercial organizations, Sir James Taylor, Governor of the Reserve Bank, issued a second draft scheme on 26 August 1937, for the direct linking of private bankers in accordance with the recommendations of the Central Banking Enquiry Committee and the regulations relating to banking companies incorporated in the Indian Companies Act as amended in 1936.[1] Briefly the Bank suggested that if the indigenous bankers were to come into practical relationship with itself, they would have to formalize their methods of banking on the lines approximating to joint-stock banks and in particular develop the deposit side of banking activities. Indigenous bankers with owned capital of at least Rs. 2 lakhs—which might be raised to Rs. 5 lakhs at the end of five years—would be entitled to apply for registration in the books of the Reserve Bank as private bankers. They must wind up their non-banking business within a reasonable time. They would not have to furnish compulsory deposits unless their time and demand liabilities were five times and more in excess of their capital in the business. They must maintain proper books of accounts and have them audited by registered accountants. They must file with the Reserve Bank periodical statements of their affairs and must also in the interest of their depositors publish the returns prescribed for banking companies. Indigenous bankers satisfying these conditions would have the privilege of direct rediscount with the Reserve Bank against eligible paper, the right to secure advances against Government Paper, and remittance facilities similar to those for the scheduled banks.

The replies to this scheme received from the shroffs and commercial bodies show that generally the indigenous bankers disagree with the suggestions regarding taking of deposits and giving wide publicity to accounts. They are also not prepared to confine themselves to banking business. They thus desire the Reserve Bank's scheme to be so modified as to be incompatible with its main proposals. The Reserve Bank has therefore informed the Government of India that it cannot recommend any immediate legislation to amend the Reserve Bank Act in regard to the extension of its provisions relating to scheduled banks to the private bankers, though, as mentioned in the Bank's Statutory Report on Agricultural credit (issued in December 1937) the offer made in its letter of 26 August 1937 is still open and the Bank will be prepared to take the matter up with the Government with a view to amending the Act, if the indigenous bankers are

[1] See §21.

prepared to conform to its conditions or suggest any other practical alternative. In the meantime, the Reserve Bank is considering whether it would be possible to develop open market operations in trade bills as this would give first-class indigenous bankers closer relationship without the necessity of making any radical changes in their present business methods.[1]

It is very unfortunate that there exists at present a deadlock between the Bank and the indigenous bankers. We believe that this problem is one of proper rapprochement. On the one hand, the Reserve Bank should realize that modern banking standards cannot be immediately applied to the shroffs and a certain temporary relaxation is necessary to enable them to come within its orbit. Ultimately, however, the shroffs must come into line with the scheduled banks as much in their own interest as in that of the Reserve Bank, which as the Central Bank of the country has to hold the balance even between the various constituents of the Indian banking system.

As regards the hope of the Bank that the ultimate solution of this problem could be found in the development of an open bill market in which first-class bills are freely negotiated, as the Bank itself realizes there are many difficulties in the way. This question is fully discussed in §29 below.

§6. **Beginnings of modern banking.**—The European system of banking was first introduced into India by the Agency Houses of Calcutta, which started a banking side as an aid to the conduct of their business. In their capacity as bankers, the Agency Houses did business with the merchant princes in India and with the planters, advancing loans on mortgages of ships, indigo factories, etc. The European community in India and the English officers of the East India Company deposited their savings with them in preference to investment in public securities, owing to the attractive rates of interest offered by the Agency Houses. The Agency Houses came to grief as a result of engaging in speculative transactions, and the commercial crisis of 1829-32 put an end to them. The banks managed on European lines were thus not at first joint-stock banks, nor are they so exclusively at the present day. European firms like Cox or Grindlay, and navigation companies like the Peninsular and Oriental, have a banking side to their business. The first purely banking institution on European lines was the Bank of Hindostan, established in Calcutta by Messrs Alexander & Co. The bank disappeared in the crisis of 1829-32

[1] *Annual Report of the Reserve Bank of India* (1937), pp. 8-9 and *Statutory Report of the Reserve Bank on Agricultural Credit*, pp. 42-3.

when the firm of Messrs Alexander failed along with others. On their ruins arose the Union Bank, a joint-stock bank created by co-operation among all the leading Calcutta houses, but this also disappeared in 1848.[1]

§7. **The Presidency Banks.**—The foreign trade of the country was comparatively small in the earlier part of the nineteenth century, and the financing of the internal trade was looked after by the indigenous bankers already described. As trade gradually developed, the need for banks of the European type was experienced, added to which was the interest of the Company's Government in regard to their own banking business. Reliance on the Agency Houses or on the Indian bankers was being found so expensive and unsatisfactory that it sufficed to overcome the reluctance which the Company had displayed so far to promote the establishment of new banking institutions. In these circumstances the Bank of Bengal, the oldest and the most powerful of the Presidency Banks, was established at Calcutta in 1806 by a charter issued by the East India Company with a capital of Rs. 50 lakhs, 10 lakhs being contributed by the East India Company. The first Bank of Bombay was established in 1840 with a capital of Rs. 52 lakhs, three lakhs of which was subscribed by the Government. This bank came to grief in 1868 as a result of its participation in the wild share speculation caused by the civil war and cotton famine in America. A second Bank of Bombay was established in the same year with Rs. 1 crore as capital. The Bank of Madras was started in 1843 with a capital of Rs. 30 lakhs, three lakhs being subscribed by the East India Company.

The establishment of the three banks put an end to the possibility of the Bank of Bengal becoming a bank for all India, an idea which had been in the air for some time.

From the very beginning, the Presidency Banks had a close connexion with the Government of the country, which not only subscribed a part of their capital, but also had the right to nominate some of their Directors. Up to 1857 the offices of the Secretary and Treasurer were usually held by a Civil Servant of the East India Company. In return, the banks enjoyed some concessions, of which the monopoly of Government banking was the most important. The right of note issue had little practical value on account of several restrictions, such as that the total liabilities on demand were not to exceed three times the cash reserves at first and four times afterwards. From 1839 onwards even the total amount up to which the notes could be issued was fixed. In 1862, as we

[1] The subsequent progress of joint-stock banks in India is reviewed in §15.

have already seen, the right of note issue was taken away, the Government having introduced their own paper currency. As a sort of compensation, the cash balances of the Government were placed with the Presidency Banks at the Presidency towns.

By the Presidency Banks Act of 1876, the Government withdrew their portion of the capital and relinquished the right of appointing Directors and Secretary and Treasurer. After this the Presidency Banks lost their official character but remained distinct from other banks, being governed by the special Act of 1876 and regarded both by the public and the Government as the most important constituents of the banking system of the country and as an integral part of the Indian treasury system. The bulk of their business was like that of any ordinary bank, namely receipt of deposits and discounting. But they acted as bankers to the Government to a limited extent. For instance, they managed the temporary public debt of the Government of India and enjoyed the privilege of using certain minimum Government balances. Although not state banks, they always had some connexion with the state, and under the special Act of 1876, the Government were entitled to audit their accounts, to call for information and to make it obligatory on them to publish weekly statements of their accounts. This public control was intended to safeguard Government interests and ensure a development of banking on sound lines in the country.

§8. **The Reserve Treasury system.**—Between 1863 and 1876 the whole of the Government balances at headquarters was kept with the Presidency Banks. But trouble having been experienced in getting the funds back from the Banks of Bengal and Bombay, the Government of India established their own treasuries (Reserve Treasuries) in 1876 at Bombay, Calcutta and Madras. The Government balances henceforward were held largely in these three Reserve Treasuries, only small amounts—just enough for safety and day-to-day requirements—being held in the district and taluka treasuries. Under the new arrangements which came into operation in 1876, the Government agreed to pay interest to the banks on the difference between the actual deposits and the minima fixed, in case the former fell short of the latter, but they gave no undertaking to keep any balances whatsoever with the banks. Actually the banks held cash balances generally in excess of the minima, though they were far from satisfied with this. A large amount of revenue flowed into Government Treasuries and remained locked up there, especially at a time when it was badly wanted by the money market. Broadly speaking, November to June is the busy season in India, and July to October is the slack season (except in Calcutta, where the busy season falls between July and

October). The receipts of revenue are heaviest during the four months from January to April, so that the heavy revenue period synchronizes with the active business season. The Government had to maintain large working balances, as the receipts of revenue are very unevenly distributed throughout the year, whereas their expenditure proceeds at an even pace.[1] It was, however, generally felt that it was possible for the Government to extend greater assistance to the money market without endangering their own safety.

Various proposals were made from time to time that loans should be issued to the public for short terms from the Reserve Treasuries through the Presidency Banks. The Government were unwilling to accept these proposals on the ground that in the peculiar circumstances of India they were subject to sudden calls and emergencies, and that loans, besides being unsafe to the Government, would also be undesirable for trade itself, which was likely to be led into dangerous commitments if it came to regard capital supplied by the Government, and not representing the savings of the community, as a resource that could be relied upon. Persistent representations, however, evoked a qualified response, and the Government of India proposed to the Secretary of State in 1898 that as part of the business management of the Treasury balances, money should be lent to the Presidency Banks at 1 per cent less than the declared minimum rate of interest during the months of January to May of each year. The Secretary of State accepted the proposal, subject to the condition that these loans should not be allowed to interfere with the Government disbursements in India and remittances to England, and that they should be made at the current bank rate. These conditions being too rigid, loans from the Government were rarely resorted to. The Chamberlain Commission proposed, as an alternative to the partial or complete abolition of the Reserve Treasury system and the transfer of these funds to the Presidency Banks, that these conditions should be relaxed and that loans should, in the first instance, be given to the Presidency Banks at 1 or 2 per cent below the bank rate. During the War, the Government placed large funds—much in excess of the minima—at the disposal of the Presidency Banks in order to facilitate the investment by the public in the War loans. The Reserve Treasury system was abolished in 1921, and the Government balances over and above those in the district and sub-treasuries were kept with

[1] See P. K. Wattal, *The System of Financial Administration in British India*, pp. 200-2.

the Imperial Bank at its head offices and its branches until the establishment of the Reserve Bank in 1935, when they were handed over to that bank.

§9. **Business of Presidency Banks: permissions and prohibitions.**—The Presidency Banks were permitted to do certain kinds of business and prohibited from doing certain other kinds. Briefly, (i) the banks were excluded from dealing in foreign exchange (except as regards Ceylon in the case of the Bank of Madras); (ii) they were also prohibited from borrowing money abroad; and lastly, (iii) there were certain restrictions as to the amount of the advances and the period for which they were made, as well as the securities against which they could be made.

Turning to the business permitted to the banks, they could receive deposits and invest in Government and other specified securities of public bodies and corporations. They were allowed to draw and discount bills of exchange payable in India. They could advance funds against accepted bills of exchange and promissory notes, accept securities for safe custody, and buy and sell gold and silver and manage Government loans at the Presidency towns and the debt business of certain municipalities. Some of these restrictions were due to the jealousy of the East India Company, which first imposed them, especially those in regard to the raising of funds in London. The exclusion from foreign exchange business was due to the supposed uncertainties attendant on it.

§10. **Progress and relative position of the Presidency Banks.**—All these restrictions and handicaps, however, did not prevent the Presidency Banks from prospering greatly. The restrictive provisions, while they hampered an even more rapid development than was actually achieved, conduced to the stability and strength of the banks. As we saw above, the Government always kept some balances with the banks, which were usually in excess of the minima fixed, and, wherever they had branches, the banks also did some general banking business for the Government, for which they received a fixed remuneration. Further, the banks undertook to provide special facilities for the encashment of the currency notes at their branches in order to popularize them. This association of the banks with the Government added greatly to their prestige and stood them in good stead, since it attracted private deposits and banking business on profitable terms and helped them to acquire and maintain a position of pre-eminence in the banking system of India. The following table gives an idea of the progress made by all the three Presidency Banks from 1895 to 1920.

(In lakhs of rupees)

Year	Capital	Reserve	Govt. Deposits	Other Deposits	Cash	Invest-ments	Dividend per cent
			Bank of Bengal				
1895	200	68	184	677	422	132	10
1913	200	191	301	1,824	840	319	14
1920	200	210	434	3,398	1,221	910	19½
			Bank of Bombay				
1895	100	51	76	358	228	105	11
1913	100	106	200	1,015	477	232	14
1920	100	120	349	2,748	876	298	22
			Bank of Madras				
1895	50	16	45	278	144	45	10
1913	75	73	86	805	219	177	12
1920	75	45	118	1,579	505	211	18

As the table shows, in point of financial strength the Bank of Bengal stood first, the Bank of Bombay second, and the Bank of Madras last. In the case of all the banks there was scarcely any increase in the capital since they were started, and consequently a growing disproportion between the amount of capital and the total business transacted. The table also shows a steady growth in the amount of private deposits, especially during the War period. The banks exhibited a strong cash position, keeping on an average cash reserves much over 30 per cent of their liabilities. The rapid development of the business of the banks can also be clearly seen from the progressive increase in their investments and the high rates of dividend declared by them, more particularly during the War period.

§11. **Exchange banks (Foreign banks).**—The Presidency Banks, as mentioned above, were prohibited from dealing in foreign exchange and from raising funds outside India. But both these matters assumed greater and greater importance with the expansion of the country's foreign trade, and there was ample room for another class of banks dealing principally with foreign exchange.

The Indian joint-stock banks rarely engaged in this business for lack of the necessary training and experience and the want of access to the London money market. In the pre-War period the only important Indian joint-stock bank which had a branch in London, like the exchange banks, was the Indian Specie Bank, but its London branch was apparently opened in order to facilitate the bank's dealings abroad in silver and pearls. The Alliance Bank of

Simla (liquidated in 1923) and the Tata Industrial Bank (amalgamated with the Central Bank of India in 1923) also did ' as much exchange business as any exchange bank in India during the first few years of its life'.[1] A few of the existing joint-stock banks do take some part in this business but have not yet developed it to any great extent.

The foreign exchange business is thus virtually a monopoly of the foreign banks. Indians have not so far been able to start exchange banks of their own owing to the competition of well-established non-Indian exchange banks, absence of branches in London and other foreign centres (which are essential for engaging in arbitrage and direct exchange transactions) and their limited financial resources. The principal difficulties in the way of establishing branches at foreign centres are (i) lack of large capital to command credit in the money markets of these centres; (ii) initial loss in working until the foreign branches become self-supporting; (iii) absence of a dependable staff trained in international exchange work; (iv) hostility of foreign banks and (v) the existence of their head offices in India which would handicap Indian banks in keeping themselves in close touch with the international monetary conditions and securing import and export bills, and bills for collection.[2] A very commendable step forward was taken in 1936, when the first Indian exchange bank (Central Exchange Bank of India) was opened in London by the late Sir Sorabji Pochkhanawala under the aegis of the Central Bank of India. It worked for two years and it is regretfully learnt that it has recently (1938) been amalgamated with Barclay's Bank, London.

Owing to the predominance of England in the foreign trade of India and the fact that London was the financial centre of the world, the early exchange banks established in India were due to English enterprise and had their head offices in London. But later on, as the country was opened to every nationality, branches of the principal banks in some countries other than England were started. The disturbance in the course of Indian trade and the important position attained by some foreign countries, that had not counted for much before in the international trade of India, acted as a stimulus to foreign banks opening their branches here. So that although the exchange banks carrying on business in India are mostly branch agencies of banks having their head offices in London, the number of those with their head offices in continental countries, in the Far East, and in the United States, has increased. The

[1] H. Sinha, *Early European Banking in India*, p. 220.

[2] *C.B.R.*, 424; also S. G. Panandikar, *Banking in India*, pp. 156-7.

exchange banks can be classified as (i) those doing considerable business in India, and (ii) those which are merely agencies of large banks doing business all over Asia. Illustrations of the former are the National Bank of India, the Peninsular and Oriental Banking Corporation, and the Chartered Bank of India. Examples of the latter are the International Banking Corporation, the Bank of Taiwan, the Yokohama Specie Bank, and the Banco Nationale Ultramarino.

§12. **The business and present position of the exchange banks.**— Originally the business of the exchange banks was confined almost exclusively to the financing of the external trade of India. But in recent years most of them have also taken a considerable part in financing the internal trade at the places where their branches are situated. For example, the piece-goods trade in Delhi and Amritsar and the leather trade of Cawnpore are largely financed by them. They do a certain amount of business on the lines of any ordinary bank. But their main business in India is financing foreign trade by the purchase and discount of foreign bills of exchange. The import bills are negotiated in England and other foreign centres and are payable in India. But by far the greatest proportion of the bills in which the exchange banks deal are export bills drawn by Indian exporters against credits opened with the London banks or finance houses, by London importers. These bills, which are drawn usually at three months' sight, are mostly documents on acceptance (D.A.) though a few are documents on payment (D.P.). The D.P. bills are held by the London offices of the exchange banks until they are retired or paid on maturity. The D.A. bills are generally discounted or rediscounted immediately after acceptance. They are rediscounted in the United Kingdom by the English and Scotch joint-stock banks or by the Bank of England. In this way the exchange banks receive back in sterling the equivalent of what they paid in rupees in India. They may sometimes hold the bills till maturity in case trade is slack and there is no immediate demand for the employment of funds in India.[1] Thus the export trade of India is largely financed by the funds of the British banks. The facility of rediscounting bills in the London money market, where the rate of discount is usually lower than in India, is a great advantage, as the exchange banks buy far more export bills than they can possibly hold until maturity. The absence of this facility in the case of the Indian joint-stock banks

[1] The bulk of the bills between India and Europe, the United States of America and the colonies are drawn in sterling while those between India and Japan are drawn in yen. Bills between India and China are drawn in rupees.

makes it extremely difficult for them to compete with the foreign exchange banks whose large profits are protected by established and not easily assailable advantages.

The purchase of Indian export bills by the exchange banks means a transfer of their funds to London. To bring their funds back to India, the exchange banks were in the habit of freely purchasing Council Bills and Telegraphic Transfers in London, so long as this system lasted. Now they effect this transfer by selling sterling to the Reserve Bank of India (which is responsible for making sterling remittances to the Secretary of State) against their London balances. There are other methods also by means of which they increase their funds in India, for example, by cashing the import bills when they mature; by the sale of drafts, and by telegraphic transfers in India for Indian students and travellers abroad and other persons requiring money to be remitted from India; by buying rupee paper in London and selling it in India, and so on. In the last resort, when there is a strong favourable balance of trade, they import bars of gold and silver bullion and sovereigns from London, Egypt and Australia. In like manner, when the balance of payments is against India the exchange banks either send gold or silver out of India. Formerly they bought Reverse Councils if the Government of India made them available. Since the establishment of the Reserve Bank of India in April 1935, they can purchase sterling drafts from the Bank for delivery in London.

The import trade of India is financed either by sixty days' sight D.P. drafts drawn on Indian importers or by London banks' acceptance of 'House paper'. The former method is usually adopted in the case of imports by Indians. These drafts (which are drawn in sterling), after being discounted by the exchange banks in London, are sent to India for collection through the exchange banks, who present them on the importers for acceptance and payment. Importers can, however, obtain delivery of the goods before payment by executing trust receipts in favour of the exchange banks and holding the goods as their trustees until the final payment. The second method is available to European importing firms who have London houses of standing. The latter draw bills on the London offices of the exchange banks which undertake to accept these bills, and thereafter they can be readily discounted in the London money market. The accepting banks in London forward the relative documents to their branches in India for the collection of the proceeds of the goods in India, and these are sent to London before the bills mature or when they are paid. In the financing of the import trade of India the more active part is

played by the head offices and branches of the exchange banks outside India. The share of the Indian branches in the business consists primarily in collecting the import bills at maturity and in furnishing their branches with information as to the means and standing of the drawees of the bills. The import bills, unlike the export bills, are as a rule not rediscounted in India, and thus the import trade is financed to a much greater extent than the export trade by the funds of the exchange banks. In order to develop a discount market for import bills it is necessary that these should be drawn in rupees and should preferably be D.A. bills. These reforms would also serve to redress the legitimate grievances of Indian importers in this respect.

Keynes points out that there is *prima facie* some danger to the stability of the Indian financial system in the fact that its money market is largely financed by funds raised not permanently, but for short periods, in a far distant foreign centre.[1] However, the greater success of the exchange banks in recent years in attracting an increasing volume of funds in India itself, clearly brought out in the following table, has to that extent diminished their dependence on the London money markets.

(In lakhs of rupees)

Year 31 Dec.	No. of Exchange Banks	Deposits (In India)	Year 31 Dec.	No. of Exchange Banks	Deposits (In India)
1870	3	52	1923	18	68,44
1890	5	7,53	1926	18	71,54
1900	8	10,50	1928	18	71,14
1910	11	24,79	1929	18	66,66
1913	12	31,03	1931	18	67,47
1918	10	61,85	1933	18	70,78
1920	15	74,80	1934	17	71,40
1921	17	75,19	1935	17	76,18

Although the banks have thus succeeded in a very striking manner in attracting deposits in India, it is desirable in the interests of safety that the sums borrowed on relatively short notice either in England or in India should not exceed the assets located there.[2] An adequate cash reserve to meet their deposit liabilities is also necessary. An important event in recent banking history in India is the entry into India of one of the English 'Big Five', which has been brought about by the acquisition of the business of Cox & Co. by Lloyds Bank.

[1] See J. M. Keynes, *Indian Currency and Exchange*, p. 212.

[2] Keynes, op. cit., pp. 212-13.

The following table gives a general view of the position of the exchange banks as it stood on 31 December 1935.

No. of Banks	Paid-up capital	Reserve and Rest	Deposits		Cash Balances	
			Out of India	In India	Out of India	In India[3]
	£(1,000)	£(1,000)	£(1,000)	Rs. (1,000)	£(1,000)	Rs. (1,000)
A[1] 7	10,019	8,985	67,493	50,49,65	11,733	7,73,22
B[2] 10	69,029	49,001	978,973	25,68,68	199,572	4,81,86

§13. **Restrictions on foreign banks.**—The question of subjecting foreign banks to certain restrictions for safeguarding national interests is part of the general question of controlling foreign capitalistic enterprise in this country. This we have already discussed,[4] and the case for restriction of foreign banking institutions, such as the existing exchange banks, is based on grounds with which we have already become familiar in the course of this general discussion. Foreign capital engaged in banking in India has laid itself open to the same kind of criticism from the national point of view as foreign capital engaged in other spheres and has prompted a similar demand for more or less strict regulation.

The share of Indians in the foreign trade of India is less than 15 per cent of the total of Rs. 600 crores.[5] There is thus a considerable loss in the shape of commission, brokerage, and insurance paid to non-Indians. It is believed that this preponderance of the non-Indian element in the foreign trade of India is due to the large facilities given by the non-Indian exchange banks to their nationals operating in India. Also, as we have already seen, these exchange banks have almost a monopoly of the financing of the foreign trade of India and it is alleged that they use their monopolistic position to the prejudice of Indian merchants.[6]

[1] A=banks doing a considerable portion of their business in India, i.e. having 25 per cent or more of their deposits in India.

[2] B=banks which are merely agencies of large banking corporations doing the major portion of their business abroad, i.e. having less than 25 per cent of their deposits in India. See *Statistical Tables relating to Banks in India* (1935), p. 5.

[3] Including balances with the Reserve Bank of India.

[4] Vol. I, ch. xiii, §§15-18.

[5] Pre-depression figure.

[6] It was alleged by several commercial bodies in India before the Central Banking Enquiry Committee that the exchange banks furnish unsatisfactory bank references regarding Indian commercial houses to exporters abroad, that Indian importers fail to obtain D.A. terms, that Indian importing firms are called upon to deposit 10 to 15 per cent of the value of goods with the

Certain witnesses before the Central Banking Enquiry Committee urged the regulation of the operations of the exchange banks in view of the fact that they were not subject to any legal restrictions in India and were exempt even from the limited statutory obligations imposed on Indian joint-stock banks registered in India, with the result that no separate information was available regarding their Indian business. It has also been urged that while they draw deposits in India, there is no protection extended to the Indian depositor; and lastly control is advocated on broad national grounds as in other countries like Japan, with a view to supplying a corrective to the alleged anti-Indian policy of the exchange banks and to removing the difficulties of Indian traders. (*C.B.R.*, 447.)

The Committee note that provision exists in the laws of various countries for regulating foreign banks by means of licenses granted by some prescribed authority in the country and advocate the introduction of a similar system into India partly in the interests of depositors, partly for ensuring the grant of reciprocal treatment in foreign countries to Indian banks, and partly also for giving the Reserve Bank some control over the banks operating in this country. The Reserve Bank would be the most suitable authority for undertaking the task of scrutinizing applications from non-Indian banks and for granting licenses in approved cases. But the Committee hold that, in fairness to the banks already established, licenses should be freely granted to them. Every license should be in force for a stated period and should be renewed if the licensing authority is satisfied that the provisions of the Indian law applicable to the bank, and other conditions specified in the license, are complied with. The conditions of the license which non-Indian banks wishing to do banking business in India should be required to take out, should be as follows:

(i) Furnishing the Reserve Bank with annual statements showing the assets and liabilities relating to their Indian business, as prescribed by the Reserve Bank.

(ii) Submitting, at any rate for a few years to come, to the Reserve Bank periodic reports of Indian and non-Indian business handled by them.

exchange banks in order to get a confirmed letter of credit opened (which is not the case with foreign houses), that import bills are drawn in sterling and carry a fairly high rate (six per cent) of interest, that the exchange banks discriminate against Indian steamship and insurance companies, that they do not offer responsible posts to Indians, etc. See *C.B.R.*, 439-45. The Report suggests that the Government of India should arrange suitable conventions with the exchange banks to meet the various complaints.

(iii) Other conditions might be imposed on the basis of reciprocity. There are various restrictions imposed by the laws of foreign countries on non-national banks working there. The power to impose similar conditions in the licenses granted to non-Indian banks in India would enable the Government of India to accord reciprocal treatment to non-Indian banks. (*C.B.R.*, 451.)

Mr Manu Subedar, however, holds that a system of licenses applicable to foreign banks only should be established with a view to reserving the field of banking in India for institutions registered in India. The object of licensing foreign banks is to protect different classes of the Indian public and Indian institutions from unsound foreign banks, from malpractices, unfair competition, anti-social and anti-national activities which they might indulge in. The claim of foreign banks to equality with Indian banks would mean the negation of all regulation in their case. According to Mr Manu Subedar, the basis of reciprocity in the matter of imposing restrictions on the exchange banks working in India is altogether unsuitable since at present there are only one or two Indian banks working abroad. It would also mean different restrictions on banks hailing from different countries. Finally, under the reciprocity system, British banks, which are the most substantial banks, would escape lightly since there are only a few restrictions on foreign banks in Great Britain. He proposes the following terms for the license:

(i) The licensed bank should not receive deposits in India from Indian-born persons or joint-stock companies registered in India. (ii) The licensed bank should confine its branches to the port areas only and no branch should be opened in the interior. (iii) Controlling interests, directly or indirectly, should not be acquired in Indian institutions in order to defeat the above provision or for any other motive. The existing branches of the foreign banks in the interior should be withdrawn within five years. (iv) Except the manager and one assistant in each branch under him the whole staff should be Indian. (Minority Report, *C.B.R.*, 204.)[1]

§14. **Opening of an Indian exchange bank.**—However much the present position may be improved by such restrictions on foreign banks they will not remove a fundamental source of weakness due to the very small share taken by Indians both in the import and the export trade and in the provision of banking facilities for such trade. The Central Banking Committee suggest the following

[1] Under the new Constitution established by the Government of India Act (1935), it will only be possible to impose the same restrictions on British banks operating in India as exist on Indian banks working in Great Britain.

measures for enabling India to obtain her legitimate share in the spheres of both banking and trade. (*C.B.R.*, 481):

(i) Well-established Indian joint-stock banks should open foreign connexions useful to their clients. (*C.B.R.*, 482.)

(ii) On the establishment of the Reserve Bank and the simultaneous withdrawal of the restrictions now imposed on the transaction of foreign exchange business by the Imperial Bank of India, the latter should be induced to take an active share in the financing of India's foreign trade. The Reserve Bank should enter into a definite arrangement with the Imperial Bank for a suitable period of, say, five years, by which the Reserve Bank would utilize the Imperial Bank as agents wherever the former had not a branch of its own and the latter had one, on terms to be settled between the two banks. In return for this concession it would not be unreasonable to insist on a preponderance of the Indian element in the institution receiving the concession. During the continuance of the arrangements the Imperial Bank should have 75 per cent of its directors on the local boards and a majority of those on the central board selected from Indians; and there should be no further recruitment of non-Indians to the staff of the Bank barring exceptional cases, the approval of the Finance Minister being necessary in the latter case. These conditions would meet the complaint regarding the unsympathetic attitude towards Indians of the non-Indian officials on the staff of the exchange banks and even on the staff of the Imperial Bank of India itself. (*C.B.R.*, 483.)

This recommendation has not so far been acted upon by the Government. No doubt the old restrictions on the transaction of foreign exchange business by the Imperial Bank of India have been removed since the establishment of the Reserve Bank on 1 April 1935: the former has also been appointed the sole agent of the latter; but no stipulations regarding foreign exchange business have been made nor any steps taken to secure the preponderance of the Indian element in the Imperial Bank.

(iii) If, however, the Reserve Bank finds it impossible to arrive at a satisfactory settlement with the Imperial Bank or finds that within the stipulated period the Imperial Bank is unable to participate actively in the financing of India's foreign trade, the establishment of an Indian exchange bank is recommended. (*C.B.R.*, 485.)

Such a bank should have a capital of Rs. 3 crores subscribed in the first instance by joint-stock banks registered in India. If the share capital is not fully subscribed within a prescribed time, the balance should be supplied by the Government, which should

arrange gradually to dispose of their holding later to the general public. So long as the Government hold more than 50 per cent of the capital, they should have a predominating voice in the appointment of the directors. The question of entrusting the work connected with Government remittances to a department of the new bank working under the control of the Reserve Bank should be considered in consultation with the Reserve Bank subject to the stipulation that the new bank shall not be allowed to make a profit on such remittances purchased in the open market in its capacity as agent.

In a Minute of Dissent signed by six members of the Committee (including Sir Purshotamdas Thakurdas) it is urged that the state should forthwith start an exchange bank with a capital of Rs. 3 crores, all to be taken up by the state. It should be allowed to finance export and import trade in the same manner as any other exchange bank. For the direction of such a bank, the state should constitute a board of seven persons at the head office of the bank with boards of five persons at important centres where the bank should have branches, and nomination to both the central and local boards should be made by the Government. In order to ensure the bank having a reasonable start, Government remittance business should be done through it. When the Reserve Bank comes into being the exchange bank will act merely as the agent of the Reserve Bank when operating in the open market on behalf of the state. The staff should be Indian except where the Finance Minister may be advised to have the services of a non-national from abroad for a few years in the beginning. (*C.B.R.*, 30.) The six members hold that the creation of an Indian exchange bank is a matter of immediate necessity, whereas years may pass before effect could be given to the recommendations of the Majority.

(iv) In conclusion, we may invite attention to the proposal of the Central Banking Enquiry Committee that joint banks controlled by Indians and non-Indians as equal partners should be established. This plan seems to be attractive. Since international trade is conducted between two parties it stands to reason that they should co-operate with one another in the financing of that trade.

§15. **History of joint-stock banks.**—The growing mass of internal commerce in India required organized banking of the modern type. Neither the Presidency Banks, which were semi-public institutions subject to various restrictions and which had branches only in a few large towns, nor the exchange banks, which were mainly preoccupied with foreign trade finance, were able to supply the need of the country in this respect. Until 1860, when the principle of limited liability was recognized for the first time

in India, the progress of organized banking was slow. The financial crisis in Bombay caused by the cotton boom of 1865 and the fall in the exchange value of the rupee prevented substantial progress from being achieved. The earliest bank of this description was the Bank of Upper India (1863), which was followed by the Allahabad Bank in 1865, and some more banks, one of which was the Alliance Bank of Simla (1874) which went into liquidation in 1923. In 1870, seven such banks were in existence. In 1894 the number rose to fourteen. Most of them were, and continue to be, under European management. The first bank due to Indian enterprise was the Oudh Commercial Bank, started in 1881. In 1894 the Punjab National Bank was established, mainly through the efforts of Lalla Harkishen Lal, who was also responsible for the establishment of the People's Bank in 1901. The People's Bank made great strides and at the time of its liquidation in 1913 it had nearly 100 branches and its deposits were over Rs. 1¼ crores.[1] One of the results of the advent of swadeshi-ism in 1905 was a flood of new creations, especially in western India, the United Provinces and the Punjab. It was to this epoch that the Bank of India, the Bank of Burma, the Indian Specie Bank, the Central Bank of India, the India Bank (Madras), the Punjab and Sind Bank, the Bank of Mysore, the Bank of Baroda and the Bombay Banking Company owed their origin.

§16. **Bank failures.**—In the first few years great progress was made by most of these banks, but the business of many of them was of so unsafe and speculative a character, and their cash reserves were so slender in proportion to their liabilities, that it was easy for a trained and gifted observer like Mr J. M. Keynes to predict speedy disaster, and Mr Keynes had the melancholy satisfaction of very soon seeing his prophecy come true.[2] The failure of the People's Bank on 20 September 1913 was followed by numerous other failures, including that of the Specie Bank in November 1913. In the course of the year 1913-14 as many as fifty-five banks went into liquidation. The War and post-War boom gave another impetus to new flotations, and when the depression set in, a large number of failures took place. Eleven banks failed in 1915, thirteen in 1916 and sixteen in 1918. The years 1913-24 were a critical period for joint-stock banking in India. As many as 161 banks failed during

[1] See Thakur, op. cit., pp. 31-2.

[2] J. M. Keynes wrote in 1913 on the eve of the bank failures in India: 'In the case of the smaller banks, dealing as they are with clients to whom banking is a new field and in a country where hoarding is still dominant, the cash balances seem, from available indications, to be hopelessly inadequate; and it is hard to doubt that in the next bad times they will go down like ninepins.'—*Indian Currency and Finance*, p. 225.

this period, and the paid-up capital of these banks amounted to about Rs. 6¾ crores.[1] Of the post-War failures, the most important was that of the Alliance Bank of Simla in 1923, which had far-reaching and disastrous consequences. Even more serious than the direct loss sustained by the depositors, most of whom belonged to the middle classes, was the shock to public confidence, the setback to habits of investment, and the injury to industrial and commercial development.

§17. **Causes of the bank failures.**—The causes of the failures, particularly of those which occurred in 1913-14, were (i) slender percentage of cash to deposit liabilities, the average being 10 to 11 per cent; (ii) unbusiness-like rates of interest offered in order to attract deposits; (iii) absence of able managers and directors with the required knowledge of banking business and practice, and lack of proper supervision by the Board of Directors;[2] (iv) fraudulent dealings on the part of some of the directors and managers; (v) absence of a proper proportion between the authorized and the subscribed capital, and between the subscribed and paid-up capital; (vi) the gullibility of the depositors who were easily misled by the window-dressing of balance sheets and the payment of high dividends even from capital; (vii) lack of palliative remedial action such as the Government themselves or quasi-Government agencies might have supplied.[3]

Some critics foolishly hinted that the bank failures demonstrated the incapacity of Indians to conduct organized banking of the modern type. But it must not be forgotten that such failures were a common feature of the early history of joint-stock banking even in England and the United States, which are at the present time in the forefront in banking matters. Again, as Mr Doraswami remarks, 'the path of Indian bank failures is strewn with the wreckage of European-manned institutions',[4] and he instances the failure of the first Bank of Bombay (1868) and the Arbuthnot Bank, to which we may add the more recent big failure of the Alliance

[1] *C.B.R.*, 29.

[2] 'It was a case of an army going into battle without any trained officers and without any orders from the General Staff.'—Findlay Shirras, *Indian Finance and Banking*, p. 336.

[3] There was no tradition of co-operation between the banks themselves, and it was suspected that the European banks did not show any great anxiety to come to the rescue of the Indian joint-stock banks. For example, the Bank of Bengal refused to accommodate the People's Bank of India even on the security of Government paper. There was also a want of co-operation and co-ordination between the Indian banks themselves.

[4] See S. V. Doraswami, *Indian Finance, Currency and Banking*, p. iii.

Bank of Simla. Although fraudulent manipulation was proved in some cases, the principal cause of the failures was lack of experience and knowledge. The failures enforced the lesson that banking is neither 'fool-proof' nor 'knave-proof', that it was necessary to minimize the risks of crisis by improving the banking machinery, by a careful selection of officers, directors and auditors, and adherence to sound banking methods.

The bank failures had at least one good effect, viz. that they removed the weak spots in Indian banking, although some deserving banks also failed along with many undeserving ones. They further demonstrated the necessity of a central bank like the Bank of England to guide the general banking policy in a time of crisis and to see to it that in normal times banking is conducted on sane and sound lines, for example by withholding accommodation or assistance in the case of ill-conducted banks. As Mr Findlay Shirras points out, sound banking in India (as elsewhere) depends not merely on good laws but also on good bankers. The failures showed how necessary it was to make suitable provision for thorough instruction in the theory and practice of banking. Equally important with good banking laws and well-trained bankers is wide publicity, to enable the public to make a shrewd guess as to the position of a bank's affairs at any given time. It is true that only very few shareholders or depositors will be able to probe the mysteries of a balance-sheet, however simplified. But every opportunity must be given to those who wish to look closely into the affairs of a bank, and it is much to be desired that the number of wide-awake, intelligent and critical people willing and able to exercise a close supervision on the management of a bank should come to be far greater than it is. It is also essential that the banks themselves should develop high and honourable traditions and a sense of responsibility to the public.

§18. **Importance of adequate cash reserves.**—The maintenance of sufficient cash reserves is the very A B C of sound banking. But it is the experience of most countries that banks learn this salutary lesson only after a reckless disregard of it has actually caused a series of disasters. Indian joint-stock banking has already paid very heavy school-fees in the shape of bank failures but seems to have at last learnt the lesson thoroughly, and the laudable desire to maintain strong reserves has been latterly more and more in evidence. The table overleaf shows the manner in which the three main types of bank in India have interpreted their responsibilities in this connexion.

The percentages for the exchange banks have been calculated on their deposits and cash balances in India only.

Proportion per cent of cash to liabilities on deposits of the several classes of banks on 31 December

	1904	1908	1910	1913	1917	1920	1923	1925	1929	1933	1934	1935
I. Imperial Bank of India[1]..	40	33	31	36	45	30	18	21	18	23	23	25
II. (*a*) Exchange Banks[2] ...	29	17	16	19	40	30	19	13	15	12	10	15
(*b*) Exchange Banks[3] ...	34	27	21	17	160	58	27	15	10	6	13	19
III. (*a*) Joint-stock Banks[4] ...	12	15	11	18	25	23	17	19	14	15	15	23
(*b*) Joint-stock Banks[5] ...	...	...	...	16	21	18	19	20	13	17	14	16

The above figures show that while the cash position was deteriorating all round in the pre-War period, it was on the whole more satisfactory in the case of the Presidency Banks, less so in the case of the exchange banks and least satisfactory in the case of the Indian joint-stock banks.

The lesson of the bank failures of 1913-14 seems to have been taken to heart by all classes of banks, especially by the Indian joint-stock banks, as is shown by their improved cash position, though this was partly due to the panicky conditions created by the War, which required stronger cash reserves than normally. Naturally since the end of the War the cash position has been somewhat less strong than in the War-period. The tendency, however, needs to be carefully watched and resisted. The matter is so important that the Bombay Banking Enquiry Committee suggested that banking agencies should be compelled by law, as in the United States of America, to maintain an adequate cash reserve. The Central Banking Enquiry Committee, however, did not favour this proposal. They were apprehensive that the statutory minimum might be regarded as the maximum by the management of the banks and that there were many ways of evading legal requirements. The Committee preferred to leave the matter to the good sense and discretion of the banks themselves. (*C.B.R.*, 706.) The recently (1936) amended Indian Companies Act, however, has made a provision for the keeping of minimum cash reserves. (See §21 below.)

§19. **Growth of joint-stock banking.**—The following statistics[6] give a general idea of the progress of joint-stock banking in India during the last sixty years or so.

[1] Before 1921, the Presidency Banks.
[2] Doing a considerable portion of their business in India.
[3] Agencies of large banks doing business all over Asia.
[4] Having capital and reserve of Rs. 5 lakhs and over.
[5] Having capital and reserve of between Rs. 5 lakhs and 1 lakh.
[6] *Statistical Tables relating to Banks in India* (1935), Table No. 4.

Capital, Reserve, Deposits and Cash Balances of the Principal Indian Joint-Stock Banks (in lakhs of rupees)

Class A.—Banks with Capital and Reserve of Rs. 5 lakhs and over.

Year 31 Dec.	No. of Reporting Banks	Paid-up Capital	Reserve and Rest	Deposits	Cash Balances
1870	2	9·8	1·8	13	5
1880	3	18	3	63	16
1890	5	33	17	2,70	55
1900	9	82	45	8,07	1,19
1910	16	2,75	1,00	25,65	2,80
1913	18	2,31	1,32	22,59	4,00
1914	17	2,51	1,41	17,10	3,53
1918	19	4,36	1,65	40,59	9,48
1920	25	8,37	2,55	71,14	16,30
1921	27	9,38	3,00	76,89	15,65
1923	26	6,89	2,84	44,52	7,37
1925	28	6,73	3,86	54,49	10,09
1929	33	7,87	3,67	62,72	9,05
1932	34	7,82	4,40	72,34	9,76
1933	34	7,78	4,55	71,68	10,92
1934	36	7,99	4,68	76,77	11,14
1935	38	8,17	5,02	84,45	19,12(*a*)

Class B.—Banks with Capital and Reserve between Rs. 1 lakh, and Rs. 5 lakhs.

1913	23	39	11	1,51	24
1914	25	42	13	1,26	27
1918	28	48	14	1,55	36
1920	33	61	19	2,33	42
1921	38	77	23	3,26	43
1923	43	81	30	3,26	61
1925	46	80	37	3,41	67
1929	45	75	40	3,58	45
1932	52	85	44	3,93	68
1933	55	87	43	4,75	82
1934	69	94	54	5,11	71
1935	67	94	57	5,44	85

On 31 December 1935 there were 105 joint-stock banks in India having capital and reserve of one lakh and over. Their paid-up capital was Rs. 9,11 lakhs, reserve and rest Rs. 5,59 lakhs, deposits Rs. 89,89 lakhs, and cash balances Rs. 19,97 lakhs. Out of these, six banks between them accounted for by far the greater part of the deposits. Leaving aside the Banks of Mysore and Baroda which enjoy State patronage, the remaining four institutions are really the sole important instances in India of purely private enterprise engaged

[1] These Banks are scheduled to the Reserve Bank of India Act.

(*a*) Including balances with the Reserve Bank of India.

in joint-stock banking. These are the Bank of India, the Central Bank of India, the Punjab National Bank, and the Allahabad Bank (Calcutta).[1] Of these only the Central Bank of India and the Punjab National Bank are Indian-managed. As the table given above shows, (i) owing to the failures of 1913-14 banking received a setback; but (ii) beginning from 1915 there was a steady expansion of banking resources, especially of deposits, which reached the record figure of Rs. 80 crores in 1921 (this expansion was partly due to the War-time inflation of deposits and the post-War boom in banking company flotations). (iii) Since 1921 there has been a decline, especially marked in the year 1923 which was a black year for banks in the post-War period. (iv) Since then recovery has been noticeable. The economic depression has not on the whole adversely affected the deposit position of the banks, probably because of the lack of free investment of floating funds and of the transfer of a part of the proceeds of gold exports to banks. In the year 1937 in particular, there was considerable expansion of joint-stock banking, as is shown by the greatly increased activity in branch banking, especially in South India (see §66 below). Nevertheless the position of the joint-stock banks cannot be said to be very strong. Their difficulties have been enhanced by the competition of the Imperial Bank and its branches, the exchange banks and their branches in the interior, the co-operative banks, the Postal Savings Banks and the Cash Certificates system. The joint-stock banks have so far received little encouragement from the Government and public bodies.

Two important events in the history of Indian joint-stock banks which occurred in 1923 deserve special notice. The first was that the Tata Industrial Bank, started in 1918, was merged in the Central Bank of India, which has now established its position under capable Indian management as one of the leading joint-stock banks in the country. This constitutes an exception to the general tendency in Indian banking which is against such mergers or amalgamations.

The second event which dominated the banking situation in 1923 was the failure of the Alliance Bank of Simla. The Imperial Bank of India undertook to pay the depositors of the Alliance Bank 50 per cent of the amount due to them, on receiving a guarantee from the Government of India that they would meet the losses consequent upon the failure. The Government's justification for intervention was that the failure of such a bank would have been disastrous to other banks, and that, if the panic had not been averted by prompt action, Indian banking would have received

[1] Gubbay, op. cit., pp. 4-5.

another serious setback. The critics of the Government contrasted the attitude of zealous sympathy displayed by them as well as by the Imperial Bank towards the Alliance Bank with the indifference shown towards the Indian joint-stock banks which came into trouble in the crisis in 1913-14. If in future, however, the Government and now the Reserve Bank follow up this precedent by coming to the rescue, whenever necessary, of deserving banks, the bitterness of feeling engendered by this alleged partiality will disappear.

There is great scope for the expansion of joint-stock banks in the country under the guidance of the newly established Reserve Bank. The joint-stock banks can themselves learn much from their competitors on both sides. As the Central Banking Committee point out, they should combine the economical management of the indigenous bankers with the efficiency and modern methods of the western institutions. (*C.B.R.*, 568.)

§20. **Regulation of banking.**—In view of the alarming succession of bank failures described above, and for securing the development of banking on sound national lines, it is generally felt that purposeful regulation is necessary. The position in India in this respect until recently (1936) was unsatisfactory, the Government following the traditional policy of *laissez-faire.* The joint-stock banks were governed until 1936 by the Indian Companies Act of 1913 in common with other joint-stock companies, and only a few sections of this Act had a special bearing on joint-stock banking. Besides, all that the old Act required was the observance of a few formalities in the matter of the preparation of the balance sheet, and the form in which the statement of affairs was to be published twice a year.

The External Capital Committee received influential evidence in favour of a more active part being played by the Government in watching over the development of banks. For example, Professor Stanley Jevons was of opinion that, in the interests of the healthy development of banking in India, the Government should undertake the inspection of joint-stock banks to ensure that proper practices were being observed, and particularly to detect at an early stage transactions detrimental to the interests of depositors and shareholders and, by fear of detection, to prevent them. The Committee did not make any definite recommendations in the matter, but merely noted the argument against such Government control, namely, that the sense of responsibility of banks and bank directors would be lessened and that it would lead to loss of efficiency, and that the best basis for sound and permanent advance lay in competition, publicity and the encouragement of private enterprise. Another argument against Government control of banks was that,

while relaxing the sense of responsibility of the banks themselves, it would throw the odium of failure or mismanagement on the Government.

The Central Banking Enquiry Committee carefully reviewed the question and formulated a scheme of regulating joint-stock banks in India. They recommended that a special Bank Act be passed comprising the existing regulations embodied in the Indian Companies Act with certain modifications and additional provisions relating to (i) Organization; (ii) Management; (iii) Audit and Inspection; and (iv) Liquidation and Amalgamation.[1]

§21. **Special provisions relating to banking companies in the amended Indian Companies Act (1936).**—After a delay of nearly five years the Government of India decided to incorporate special provisions relating to banking companies in their Indian Companies (Amendment) Bill, which became law in 1936. This course was adopted by the Government in preference to a special Bank Act on the ground that there was no immediate prospect of legislation dealing solely with this subject being undertaken. Moreover the major banks had already been dealt with partly in the Reserve Bank Act. The recommendations of the Central Banking Enquiry Committee were considered in drafting these new provisions, which are as follows:[2]

(i) A banking company has been defined as one which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order notwithstanding that it engages in addition in any or all of certain specified forms of business, such as lending of money, discounting bills, buying or selling foreign exchange, granting letters of credit, receiving valuables for safe custody, underwriting and dealing in stock, shares, debentures, etc., promoting or financing any business undertaking through syndicates or otherwise, undertaking and executing trusts. (ii) The activities of such banking companies are restricted to ordinary banking transactions by requiring the Memorandum of Association to make provision to this effect as a condition of registration under the Act. (iii) The employment of managing agents for the management of banking companies in future is prohibited. (iv) Adequate working capital before business is commenced is ensured by making necessary the issue of a certificate to the effect that working capital of Rs. 50,000 has been obtained by the allotment of share capital. (v) A banking company is not allowed to create any charge upon its unpaid

[1] See *C.B.R.*, ch. xxv; also M. L. Tannan, *Regulation of Banks in India*.

[2] Act XXII (an Act further to amend the Indian Companies Act 1913, for certain purposes) of 1936, Part XA, sections 277F to 277N.

capital. (vi) A Reserve Fund is made compulsory by requiring a transfer out of the annual profits, before any dividend is declared, of a sum not less than 20 per cent of such profits to the Reserve Fund until the Fund equals the paid-up capital. (vii) A minimum cash Reserve of 1½ per cent of the time liabilities and 5 per cent of the demand liabilities is to be maintained, and monthly statements of the amount so held and of the time and demand liabilities are to be filed with the Registrar by banking companies other than scheduled banks. (viii) A banking company is not allowed to form or hold shares in any subsidiary company except a subsidiary company of its own formed for the purpose of undertaking and executing trusts, or for undertaking the administration of estates, and for such purposes as are incidental to the business of accepting deposits. (ix) Provision has been made for a moratorium to save from liquidation a banking company in temporary difficulties by authorizing the Court on the application of a banking company to stay proceedings against such a company, provided the application is accompanied by a report made by the Registrar. The latter is entitled for the purpose to investigate the financial condition of the company at its cost.

While we welcome the new legislation, there is still, in our opinion, a strong case for a separate Bank Act to ensure satisfactory regulation of banks in India.[1]

§22. **Clearing houses.**—The system of 'clearing houses' was introduced in England towards the last quarter of the eighteenth century. It made possible the easy adjustment of countless cross claims without actual use of cash or money. The existence of this system explains to a large extent the phenomenal development of the cheque system in England and other countries. For the greater success of this system, it is necessary that one of the member-

[1] Banking legislation is apparently required not only to protect the depositors and shareholders from unscrupulous banking management, but also to secure the protection of the banks themselves from unjust attacks on their stability, though the right of the public and the depositors as well as shareholders to a fair criticism of the management must be carefully safeguarded. It is felt that some amendment of the Companies Act is necessary. It has been suggested that complaints against a bank should not be permitted to be brought before a court of law without preliminary inquiry and sanction by some responsible officer of the Crown, such as the Advocate-General or the Registrar of Joint-Stock Companies. It is doubtful, however, whether the grant of such sanction on a *prima facie* case would not make the position of the bank concerned much more serious than before. Fully aware of these difficulties, the Central Banking Committee have contented themselves with leaving it to the Legislature to consider whether any practical remedy could be advised to protect banks from frivolous proceedings. (*C.B.R.*, 745.)

banks of the clearing house should act as the settling bank or the 'bankers' bank', the other banks keeping a balance with it so that the settlement of cross claims is rendered more easy and complete.

The principal clearing houses in India are those of Calcutta, Bombay, Madras, Karachi, and Rangoon (before the separation of Burma on 1 April 1937). Clearing houses have also been established in Cawnpore, Lahore, Delhi, Simla, Ahmedabad and Colombo. The Imperial Bank of India had in view the establishment of more clearing houses, namely at Amritsar, Rawalpindi and Peshawar. At many places where there is no clearing house, a system is in vogue of clearing accounts by giving cheques on the Imperial Bank in payment of balances due between the banks in the place. The Reserve Bank, the Imperial Bank, the exchange banks, the English banking and agency firms and the leading Indian joint-stock banks are most of them members of clearing houses. The Reserve Bank of India now acts as the settling or bankers' bank. A representative of each member-bank attends the meeting of the clearing house on every business day at certain times. Since the members have usually an account with the Reserve Bank, the final balance left over after the cancellation of cross claims is usually settled by cheques and book entries, thus dispensing with cash in any form. Mr McDonald, the Managing Governor of the Imperial Bank, suggested in his evidence before the Central Banking Committee that an Association of Clearing Banks should be incorporated. It should have its own rules and manage every clearing house in detail; it should have its own banker, as should every member. In India these functions were, until the establishment of the Reserve Bank of India, largely performed by the Imperial Bank. There was thus confusion, and not infrequently other banks regarded their accounts with the Imperial Bank as being nothing more than a part of the clearing house and a means of settling their differences in the clearing, and overlooked that in addition to the balance required to meet their clearing differences, their balances should have covered the work involved, as in the case of an ordinary constituent. The clearing house returns given below may be taken as some indication of the steady growth of trade and banking, though adversely affected by the economic depression, especially in the years 1931 and 1932. The use of the cheque is still in its infancy, being practically confined to the commercial towns. Nevertheless, the cheque is gradually finding its way even into the mofussil areas, and the tendency has been especially marked since the establishment of a number of branches by the Imperial Bank. The cheques issued by the co-operative banks are also

familiarizing the public in the up-country districts with the new system.

The following figures show the growth of the cheque system.

Clearing House Returns—Total amount of cheques cleared
(In crores of rupees)

Year	Amount	Year	Amount
1900	2,12	1928	18,66
1905	3,03	1929	20,48
1910	4,65	1930	18,16
1913	6,50	1931	15,73
1918	13,95	1932	15,90
1920	31,49	1933	16,34
1921	20,21	1934	17,24
1922	20,22	1935	18,85
1923	18,55	1936-7	19,32
1924	17,78	1937-8	20,51[1]

To popularize and extend the clearing house system, more facilities must be given for the clearing of cheques of private firms up-country, and the privileges of the clearing house extended to registered private banks of suitable status. The use of cheques, although it is growing, is far from being commensurate with the vast size of the country and its population. One of the hindrances to the growth of the system is widespread illiteracy. Besides, in order to write a cheque, a person must not only be literate but must also know English. This is capable of being remedied if the joint-stock banks modify some of their methods and make use of the Indian languages in their transactions, particularly in respect of cheques, pass books and deposit receipts.[2] But the greatest hindrance is the deficiency of banking facilities.

The following are some of the suggestions made by the Bombay Banking Enquiry Committee to popularize the use of cheques: (i) Cheques should be accepted in payment of land revenue, local rates and taxes; (ii) the Imperial Bank should revive the policy of charging low rates of exchange on up-country cheques; and (iii) joint-stock banks and co-operative banks should allow moneys to be withdrawn from savings banks accounts by cheques.[3]

[1] This amount, the highest since 1921-2, was distributed as follows (crores of rupees):

Calcutta 967, Bombay 816, Madras 110, Karachi 36, Rangoon 82, Cawnpore 12, Lahore 11, Delhi 18. *Report of the Reserve Bank on Currency and Finance* (1937-8), statement xvii.

[2] The abolition of the stamp duty on cheques has encouraged their use.

[3] See *Report of the Bombay Provincial Banking Enquiry Committee*, pars. 303-6.

§23. **Postal Savings Banks, etc.**—Government Savings Banks were established in the Presidency towns between 1833 and 1835. In 1817 District Savings Banks were instituted in connexion with certain select district treasuries. The Post Office Savings Banks were opened in all parts of India in 1882 and 1883, and absorbed the District Savings Banks' business in 1886 and that of the Presidency Savings Banks in 1896. The Government Savings Banks are, therefore, at present a department of the postal administration. The Government do not maintain any specific cash reserve to meet their deposit liabilities, which constitute therefore an unfunded debt used for capital expenditure. The Postal Savings Banks provide the people of the middle and lower middle classes with a secure means of depositing their small savings, for which the general balances of the Government constitute a sufficient security. Agricultural and industrial workers appear to make a negligible use of these banks. In 1914, the Government offered increased facilities to depositors by raising the limit of the amount of the annual and total deposits permissible to an individual depositor as well as by helping the depositors in their investments in Government securities. This resulted in attracting large deposits, especially because public confidence in private banks had been badly shaken on account of the bank failures of 1913-14. The War gave a temporary setback to Savings Banks deposits, but there has been an improvement in the position recently, as can be seen from the following table.

The Growth of the Post Office Savings Banks Deposits

Year	No. of Banks at the end of the year	No. of Depositors	Total deposit balances with the Government (in crores of rupees)
1913-14	9,824	1,639,000	23·16
1914-15	10,161	1,644,074	14·89
1918-19	10,587	1,677,407	18·22
1923-4	10,535	2,039,314	24·79
1925-6	11,162	2,317,390	27·23
1926-7	11,994	2,518,142	29·50
1928-9	12,684	2,020,832	34·49
1930-1	12,846	2,477,613	37·03
1932-3[1]	12,690	2,736,645	43·45
1933-4	12,677	3,089,267	52·23
1934-5	12,679	3,100,368	58·30
1935-6	12,926	3,541,553	67·25

[1] The Post Office Savings Banks deposits amounted to Rs. 74·68 and 79·65 crores (exclusive of Burma) on 31 March 1937 and 1938, respectively. See *Statistical Abstract for British India* (1935-6), Table No. 244 and *Report on Currency and Finance* (1937-8), statement xiii.

The pre-War amount of deposits has been exceeded since 1922-3 (when it was Rs. 23·19 crores), though the position is less satisfactory than it looks if we consider the period which saw a fall in the purchasing power of the rupee. The deposit balances in recent years have shown an appreciable increase—a result attributed to the investment of part of the proceeds of the sales of gold. There is a considerable scope for the expansion of Post Office Savings Banks, seeing that there were in 1935-6 only 12,926 Savings Banks for nearly five lakhs of villages in British India, which shows that in the case of a vast number of villages the nearest Savings Bank is several miles away, making it highly inconvenient for the village folk to deposit their savings there.

In recent years there have been several forms of investment open to the public which have come into competition with the Post Office Savings Banks. For example, the War loans attracted many people who would otherwise have deposited their money with the Post Office Savings Banks. Other competitors are the co-operative credit societies, the Imperial Bank and the exchange and joint-stock banks.

Among the suggestions made for making the Post Office Savings Banks more popular are the following: (i) a higher rate of interest on deposits, more in correspondence with rates obtainable elsewhere; (ii) a further relaxation of the restriction on the amount deposited annually and the limit on balances, subject to suitable precautions regarding sudden withdrawals;[1] (iii) the acceptance of deposits in the form of cheques and also the allowing of withdrawals by means of cheques; (iv) propaganda for opening new Savings Banks offices.[2]

The Post Office comes into contact with the savings of the people in another way, namely through Cash Certificates. These certificates are issued in amounts of Rs. 10 or multiples of Rs. 10; Rs. 10,000 being the maximum limit for the face value of the total holdings by one person. They are payable after 5 years from the date of purchase and are issued at a discount, full interest, i.e. face value, being payable only at the end of five years. Since the time of the War a Government Loan branch has also usually been tacked

[1] The amount that can be deposited into an account in a single year is limited to Rs. 750 and the total balance to Rs. 5,000. The minimum amount that can be deposited at any time is four annas, withdrawal being permitted only once a week. The rate of interest was reduced from 3 per cent to 2½ per cent in 1933, and to 2 per cent in 1936.

[2] The Bombay Banking Enquiry Committee recommend that 'in the experimental stage, in selected areas officers of the co-operative societies or village schoolmasters serving as part-time postmasters should be entrusted with the work of collecting deposits'.—*Report*, par. 289.

on to the Post Office. As regards the Post Office Cash Certificates the system is capable of being extended and further popularized so as to make it finance a considerable portion of the provincial capital expenditure. In 1930-1 the amount of the Postal Cash Certificates outstanding was Rs. 38·44 crores, whereas it was only Rs. 13·12 crores in 1924-5 and Rs. 8·88 crores in 1917-18, when the system was first introduced. In recent years the amount of Cash Certificates outstanding has greatly increased, being Rs. 65·98 crores on 31 March 1936, in spite of the successive reductions in the interest yield.[1] This result also has been attributed largely to the sale of gold at high prices and the investment of the proceeds in Cash Certificates. In order further to popularize Cash Certificates, it has been suggested that, as it is not possible to open a post office in every village, the village *patel* and the accountant, who collect the land revenue, could conveniently undertake the business of Cash Certificates, which may also be accepted at their realizable value in payment of land revenue.[2] On the whole the system of Cash Certificates has abundantly justified itself. However, in order to avoid unfair competition with banks and bankers, a lowering of the yield on Cash Certificates may be desirable. Also in order to meet the grievance that there is at present too great a diversion of funds outside the districts, some of the money collected through post offices may be placed at the disposal of co-operative societies, or advanced as takkavi, to individuals.

§24. **Effects of the War on Indian banking.**—One of the effects of the War on Indian banking was a remarkable increase in bank deposits. The total bank deposits of all the banks (the Presidency Banks, joint-stock banks and the exchange banks)[3] amounted to Rs. 97·51 crores in 1913 and Rs. 1,63·62 crores in 1918.

The large War profits made by some of the industries, like the cotton-mill and jute-mill industries, naturally increased the cash deposited with the banks. In addition the banks gave credit, both to the Government and private individuals and bodies, in connexion with the issue of and investment in War loans and Treasury Bills. The banks gave credit to the Government by themselves subscribing to the War loans and the Treasury Bills, and the Government drew upon this credit by issuing cheques on the banks to its creditors from whom heavy purchases of war materials, etc., had been made. These cheques were in their turn carried to their accounts at the

[1] The amount declined to Rs. 60·53 crores (including Rs. 0·32 crores in Burma) on 31 March 1938.

[2] See Wadia and Joshi, op. cit., p. 359.

[3] In the case of the exchange banks, only the deposits in India are taken into account.

banks by the Government's creditors. The banks thus found that their deposits increased by the amount of their subscription to the Government loans. The banks helped private persons and bodies to invest in War loans and Treasury Bills by opening deposit accounts with them. Thus both these sets of causes served to increase enormously the total amount of the deposits.

Another effect of the War was the worsening of the pre-War situation as regards the smallness of the capital of the banks in relation to the business transacted. This was due to the excessive anxiety of the banks to make larger and ever larger net profits by as rapid a turnover of their capital as possible.

Further, the War witnessed a very considerable growth in the cash reserves of the banks, partly owing to the increase in the deposits and partly to the necessity felt by the banks to maintain stronger reserves as a safety measure under the abnormal War conditions and as a result of the banking crisis of 1913-14, the memory of which was still fresh and vivid. There was also a considerable increase in the investments of the banks, partly owing to the great activity of the export trade, but primarily as a result of the bank's investments in War loans and Treasury Bills. The War brought higher dividends, tighter money and high bank rates, and a great increase in the amounts of cheques cleared. Lastly, the experiences of the War imparted greater urgency than ever to the question of a central bank, the need for which had already been clearly indicated by the crisis of 1913-14.

§25. **Characteristics and deficiencies of the Indian money market.**—The money market in India exhibits several characteristics and deficiencies, some of which are reviewed below. In the first place, as previously pointed out, the money market in India is divided into several segments which are loosely co-related to each other. Each sectional agency such as the Imperial Bank, the exchange banks, the joint-stock banks, the co-operative banks, the indigenous bankers, etc., limits itself to a particular class of business and remains virtually independent in its own sphere.[1] The relations between the various members of the money market are not very happy. Thus the joint-stock banks are jealous of the privileged position of the Imperial Bank, which until the establishment of the Reserve Bank performed to a limited degree the functions of a central bank. The exchange banks occupy a very strong position, and complaints are often heard that they are encroaching on the province of the joint-stock banks. Before their inclusion in the list of scheduled banks they were not amenable

[1] This criticism applies specially to the period before the establishment of the Reserve Bank.

to any law or authority in India. The link between the co-operative and other banks is also very loose. But the most serious cleavage exists, as already shown, between organized banking institutions and indigenous banking. Even the latter or the bazaar part of the money market is not one compact entity, but is further subdivided, as, for example, in Bombay where there are separate Gujarati, Marwari and Multani bazaars, each with its own rate of interest. The absence of a genuine central bank until recently (April, 1935) aggravated the separatist and centrifugal tendencies; and although the Reserve Bank of India has already commenced work no revolutionary changes can be expected in the near future. Firstly, because the relation of the Reserve Bank to indigenous bankers has not yet been settled; and secondly because before a well-organized and close-knit money market is brought into existence a certain amount of time must necessarily elapse, in order that the influence of the new central banking structure, imperfect as it is, should permeate throughout the credit organization of the country.[1]

§26. **Confusion and chaos of money rates.**—An inevitable result of the sectional organization of the money market in India is the confusion and chaos of the money rates. The Central Banking Enquiry Committee cannot be said to be guilty of exaggeration when they say, 'The fact that a call rate[2] of $\frac{3}{4}$ per cent, a *hundi* rate[3] of 3 per cent, a bank rate[4] of 4 per cent, a Bombay bazaar rate[5] for bills of small traders of $6\frac{3}{4}$ per cent and a Calcutta bazaar rate[5] for bills of small traders of 10 per cent can exist simultaneously indicates an extraordinary sluggishness in the movement of credit between the various markets '.[6] This presents a marked contrast

[1] Another defect of the Indian money market before the inauguration of the Reserve Bank of India was the dual control over the money market by the Government, which was the currency authority, and the Imperial Bank, which was the credit controlling agency to a limited degree. Further the Government dominated the money market by their currency and financial operations. The inauguration of the Reserve Bank, which is both the currency and credit controlling authority, has removed these two defects.

[2] The call or call money rate refers to the interest rate charged on surplus money seeking employment for a possibly minimum period of 24 hours.

[3] The (Imperial Bank) *hundi* rate is the rate at which the Imperial Bank will discount first-class three months' bills.

[4] The bank rate (old) refers to the rate at which the Imperial Bank, before the establishment of the Reserve Bank of India, was prepared to grant demand loans against Government securities. This is now known as the advance rate of the Imperial Bank. The basis of the bank rate as now quoted by the Reserve Bank is explained in §58 below.

[5] The bazaar rates are those at which the bills (*hundis*) of small traders are discounted by the shroffs at Calcutta and Bombay.

[6] See *C.B.R.*, 579.

with the close relation between the various money rates in the London money market, all of which depend ultimately on the bank rate and promptly adjust themselves to changes in that rate. The old bank rate charged by the Imperial Bank, though quoted in financial journals along with the bank rates of the central banks of other countries, had a different and limited significance. Whereas the rates of the central banks usually denote the rates at which first-class trade bills can be discounted at the central bank, the Imperial Bank rate was not a discount rate but a loan rate. The divided control over currency by the Government and credit by the Imperial Bank before the inauguration of the Reserve Bank made the confusion of rates worse confounded. Another characteristic of the money rates in India is the perceptible disparity in respect of them at the two principal centres, Bombay and Calcutta, leading to fluctuations in the prices of securities and reactions on trade movements. This is brought out by the table of money rates below.

Indian Money Rates per cent (1936-7) [1]

On 1st of	Bank Rate	Call Money Rate		Imperial Bank *Hundi* Rate	Bazaar Bill Rate	
		Calcutta	Bombay		Calcutta	Bombay
April 1936 ...	3	1/2	1/2	3	5-6	5 1/4
May ,, ...	3	1/2	1/2	3	5-6	5 1/4
June ,, ...	3	1/2	1/2	3	5-6	6
July ,, ...	3	1/4	1/2	3	5-6	4 1/2
August ,, ...	3	1/4	1/2	3	5-6	3 3/8
Sept. ,, ...	3	1/4	1/4	3	5-6	3 3/8
October ,, ...	3	1/4	1/4	3	5-6	3 3/8
Nov. ,, ...	3	1/4	1/4	3	5-6	3 3/8
Dec. ,, ...	3	1/4	1/2	3	5-6	3 5/8
Jan. 1937 ...	3	1/4	1 1/2	3	5-6	5 1/4
Feb. ,, ...	3	1/4	1	3	5-6	5 1/4
March ,, ...	3	1/4	3/4	3	5-6	5 1/4

We may now consider further the question of the relation between the old (Imperial) bank rate and the bazaar *hundi* rates.

We have already remarked that the indigenous banker finances the movement of crops during the busy season largely from his own resources. He is, however, ultimately dependent upon the Imperial and the other joint-stock banks for the additional funds he requires. Therefore in times of stringency the bazaar rate for first-class *hundis* follows the Imperial Bank rate. As we have seen, the shroffs who do the *hundi* discounting business charge higher rates than the bank rate, profiting by the difference between the two rates. Towards the beginning of the slack season the bank rate is

[1] See *Report on Currency and Finance for the year 1936-7*, Statement xvi.

generally higher than the *hundi* rate.[1] When money is easy the correspondence between the two rates is less close than when it is tight, and the shroffs may disregard the bank rate and may underquote the bank.[2] It should be noted in connexion with the absence of complete harmony between the two rates that the shroffs scarcely ever discount European paper and do not purchase foreign or sterling bills. 'Neither do they lend money on Government paper or similar securities, but confine their advances to the discount of *hundis*, to loans to cultivators and against gold or silver bullion.' The banks do not compete with the shroffs for the purchase of traders' *hundis* and therefore there is often little apparent relation between the shroff's rate and the bank rate. The shroff's reliance on banking funds is not sufficiently continuous or sufficiently great for the two rates to be closely similar. The operations of the shroffs still lie to a great extent outside the banking system of the country.

The natural link between the Indian money market or the bazaar, and the market controlled by banking institutions of the European type would be 'a steady supply of trade bills endorsed by reliable firms or discount houses which are in touch with both markets and are able to meet the needs at one end of the merchant who prefers the elastic methods of bazaar finance, and to take advantage at the other end of entry into the central money and discount markets'. (*C.B.R.*, 581.)

The levelling down of the various money rates must be a matter of slow growth and development. 'The ultimate ideal must be the mobilization of the whole of the floating resources of the country into one large pool, into which bills can find their way with as little delay and with the intervention of as few intermediaries as possible.'[3] The inauguration of the Reserve Bank and the expectation that it will promote the establishment of a bill market in India gives rise to the hope that the bank will put an end to the chaos of money rates and exercise control over the various money rates prevailing in the money market (see §§28-9 below).

§27. **Seasonal monetary stringency.**—Another striking characteristic (incidentally referred to above) of the money market in India is the seasonal monetary stringency and high money rates

[1] 'The *hundi* rate rises and falls with the bank rate proper, though somewhat in advance of it and naturally so, for one is a discount rate and the other a rate for day-to-day loans. Thus at the beginning of the busy season, the *hundi* rate would usually be higher than the bank rate; the reverse being the case when the slack season is about to begin, so that the *hundi* rate may be said to be a sort of long-distance signal.'—*Babington-Smith Commission Report.*

[2] See Shirras, *Indian Finance and Banking*, pp. 341-2.

[3] *C.B.R.*, 581.

during a part of the year. The year in India is divided into two more or less distinct periods: (i) November to June, which is the period of the busy season when money is required to move the crops from the up-country districts to the port towns and internal centres of consumption, and (ii) from July to October, which is the period of the slack season when the money returns to the financial centres in payment for bullion or other commodities. There are wide fluctuations of the money rates from one period of the year to another, and the spread between the maximum bank rate during the busy season and the minimum during the slack season is very striking. For instance, the highest bank rate in the year 1924 was 9 and the lowest 4, corresponding figures for 1928 being 7 and 5, for 1929, 8 and 5, for 1930, 7 and 5. During recent years of depression the bank rate has remained at a comparatively lower level and without any change during the whole year, for example, during 1933-4 and 1934-5 the bank rate remained unchanged at $3\frac{1}{2}$ per cent. This is an indication of the general slackness in the trade demand, of the prevailing low level of commodity prices, of the release of frozen credit wrought by the sale of gold, and to some extent of the feeling of ease caused by expansion of currency. The Reserve Bank of India was compelled to reduce the bank rate to 3 per cent with effect from 28 November 1935 under pressure of easy conditions and weight of money awaiting investment. It has since remained unaltered (September 1938). The bank rate[1] varies with the intensity of the demand for money, which again depends upon the nature of the harvest, the briskness of the demand for the great staples of agriculture (cotton, jute, wheat, rice, etc.), especially for export purposes, and the range of prices prevalent for them. We have already seen how the crops are financed in the earlier stages by the indigenous bankers and how a considerable volume of business is thus brought by them to the Imperial and other banks who discount and rediscount the shroffs' *hundis*. The demand for moving the crops occasions a seasonal stringency in the money market, further emphasized by the great demand for currency which comes at the same time in connexion with holidays, marriage ceremonies, etc. But apart from these causes accounting for seasonal stringency, there are other factors responsible for the normal high money rates in India (before the economic depression). We have already spoken about the part which the Reserve Treasuries played in causing monetary stringency. The transfer of large cash balances to the Imperial Bank

[1] The old Imperial Bank rate varied inversely with the cash balances, which get depleted during the busy season, and begin to swell during the slack season.

(now to the Reserve Bank) brought some relief to the money market. The Government monopoly of note-issue and its divorce from banking, until its transfer to the Reserve Bank of India, was responsible for a maladjustment between the supply of and demand for money. A certain element of elasticity was imparted to the note-issue by the provision for the seasonal issue of currency up to Rs. 12 crores against inland bills of exchange, under the Paper Currency Act of 1923. But this amount was fixed arbitrarily and its extension was widely desired by the commercial public. The rates of interest were also felt to be prohibitive. Moreover, there is a shortage of genuine inland trade bills as cover against the seasonal increase.[1] As Sir Basil Blackett pointed out to the Hilton-Young Commission, the Imperial Bank sometimes had to put some pressure on their clients to convert cash credits into *hundis* in order to leave a sufficiency of self-liquidating *hundis* to obtain emergency currency. The monetary stringency has also been attributed to the heavy borrowings of the Government in the money market since the War, which prevented the Imperial Bank from collecting sufficient surplus cash, and thus the money rates remained unduly high. The exchange policy of the Government, involving deflation or refusal to allow the normal increase in currency, also added to the monetary stringency from time to time. But from the nature of the case this cause comes into operation only occasionally. On the other hand, the purchase of sterling in India, arrangements for cheap inland remittances, and the starting of additional branches by the Imperial and other banks, have had the effect of lowering to some extent the pitch of money rates during the busy season. However, excluding the recent years of economic depression and cheap money, the normal rate for money in India is still far too high and acts as a discouragement to business activity. A fundamental reason for the high rate is the scarcity of capital, which is the direct result of the great poverty of the people. The income of the great majority of the people is so small that any saving is scarcely possible for them. Another reason is that a considerable amount of potential capital takes the form of hoards, which lie idle and sterile in the absence of adequate banking facilities to attract them into profitable investment. (The sale of large quantities of gold for export in recent years has lessened the force of this factor. It has also partially contributed to cheap money conditions and low interest rates.) These defects pointed to the need for a central banking agency which could spread the available resources more evenly over the different parts of the country and the different seasons

[1] See p. 355 above.

of the year. Now that the Reserve Bank has been established, it is expected that 'the supply of additional note currency against eligible commercial paper would be automatic and the question of penal rates of interest would not arise'. (See §53.)

§28. **Lack of a bill market.**—A well-organized bill market is an indispensable adjunct of an efficient money market and is essential for the smooth working of the credit mechanism. It is also necessary for linking up the various credit agencies ultimately and effectively to the central bank of a country. The present situation in India in this respect is most unsatisfactory. As the Central Banking Enquiry Committee point out, from the point of view of a discount market bills in India are scarce. This is not due to a lack of knowledge regarding the utility of this form (the trade bill) of credit or unwillingness to make use of it. *Hundis*, which are the analogue of the western bill of exchange, have been in use in this country from the twelfth century onwards, if not earlier. The scarcity of bills, which is clearly brought out by the very small proportion of their assets devoted to the purchase of bills by banks in India, may be attributed to the following reasons.[1] (i) In the first place, banks in India have to maintain a stronger liquid position than in western countries, and therefore a relatively very large portion of their assets is locked up in gilt-edged securities—a practice favoured so far by the attractive yield of Government securities. (ii) Secondly, banks do not make it a practice of discounting their bills with the Imperial Bank of India, as this is considered to be a sign of weakness by the market. (iii) Joint-stock banks prefer taking loans from the Imperial Bank on Government securities to offering bills for rediscounting because the latter is itself a competing commercial bank and no bank would like to give away the secrets of its bill portfolio to a rival bank. Moreover, since the Imperial Bank discounts only bills approved by it at its discretion and does not lay down any standards in this respect, the joint-stock banks cannot depend upon bills brought in by their customers. (iv) Another obstacle in the way of the development of a bill market in India is the defective grounding of the bazaar *hundi*, which is not readily acceptable to banks, who are at present compelled to insist on the personal security of the endorsing shroff, if he happens to be on the bank's list of approved shroffs. It is not clear on the face of a bazaar *hundi* whether it is a pure finance bill or a genuine trade bill, since it is not always accompanied by documents like sale contracts, invoices, documents of title, etc., whereby the bill could be supported and connected

[1] For a detailed discussion of this problem see *C.B.R.*, chapter on The Banking System and the Money Market.

with a particular lot of goods or produce. Other difficulties in the way of the free use of *hundis* are a baffling variety of languages in which the *hundis* are drawn, diversity of customs regarding days of grace, etc., widespread illiteracy of the masses, the heavy stamp duty on *mudati hundis* (usance bills), etc. (v) Another factor which prevents free development of the bill market in India is the system of cash credits which is greatly in vogue in inland trade finance in India. It offers certain advantages both to the lender and the borrower. For instance, the borrower has to pay interest on cash credit only to the extent that credits are used, and the bank can withdraw credit in the event of deterioration of the borrower's position. On the other hand there are certain advantages of bills, viz. liquidity to banks and the borrower's certainty of a definite amount of credit during the period of currency. The use of bills may be expected to be more popular, provided the banks take the initiative in the matter.

§29. **Measures to promote a bill market.**—The Central Banking Enquiry Committee have suggested various measures for the development of a bill market in India. (*C.B.R.*, 593.) (i) The Reserve Bank of India should be prepared to buy or rediscount at its published rate—which should be the minimum rate—first-class trade bills and promissory notes arising out of bona fide commercial transactions and should at its discretion charge higher rates for demand loans against authorized securities. The joint-stock banks need not look upon the Reserve Bank as their rival and may be expected to avail themselves fully of the facilities of rediscounting commercial paper offered by it (see §50 below). (ii) Discounting charges should be reduced so as to facilitate use of bills, and a clearing house for bills should be established in all provincial capitals in order to secure charging one commission only. (iii) Warehouses should be established in various parts of India to encourage the use of bills, as this would tend to replace the pure finance (or accommodation) bills drawn by merchants and shroffs by documentary bills which would be readily discounted by banks. (iv) The present high rate (18 pies per cent) of stamp duty on usance bills—which besides being very onerous at the present low money rates seriously militates against a greater use of bills—should be either abolished or appreciably reduced. Complete abolition of this duty was also strongly recommended by the Hilton-Young Commission. It is gratifying to learn that the Reserve Bank of India is pressing the Central Government of India and through them the Provincial Governments to carry out the suggestion of the Central Banking Enquiry Committee in favour of the reduction of the duty to a uniform level of As. 2 per Rs. 1,000. (v) The Post Offices

should stock printed bill forms in English and Indian languages in parallel. The noting of dishonour and protest by recognized associations of banks, shroffs and merchants should be validated to save inconvenience and trouble to the owner of the instrument. The customs governing *hundis* should be standardized with a view to promoting their circulation. Legislation may be resorted to, if necessary. (vi) Banks should take the initiative in creating bank acceptances,[1] which would be more readily negotiable than ordinary trade bills. In this connexion we welcome the efforts that are now being made by the Reserve Bank, which is actively investigating the possibility of creating a bill market by encouraging the formation of acceptance houses. (vii) A discount market should be established by the adoption of bill-broking as an integral part of the indigenous bankers' business and by the formation of discount houses under the aegis of the Reserve Bank by these bankers and their wealthy depositors.[2] (viii) The use of bills should be extended in the following directions: (*a*) Agricultural paper could be created in respect of advances granted to the ryots for the growing of crops (though this may take some time to develop). (*b*) As regards the finance that is required after the crops have been gathered, it is suggested that agriculturists may become members of co-operative godown societies and obtain finance on agricultural produce from these societies by allowing the latter to draw a four months' bill upon themselves (owners of produce). Such bills may be discounted and rediscounted with the central co-operative and other banks. (*c*) The drawing of usance bills should be encouraged for the finance of village bankers by shroffs, who can get them discounted with the banks. (*d*) An extended use of bills in marketing finance could be brought about by establishing licensed warehouses for enabling the village traders to create a documented agricultural *mudati hundi* of six months' usance, which may be accepted by a registered *mahajan*. The bill so created could be discounted in the central money market. (*e*) The movement of goods from the port town to the interior should be financed by bills which should replace the present method of granting open account credit by commission agents to the merchants in the interior. (*f*) The use of bills could also be extended in the financing of the foreign trade of the country. Rupee import bills should be introduced in place of the present sterling import bills, which cannot be dealt with by the Indian

[1] A banker's acceptance is a bill which the bank, under a prior arrangement with the purchaser of goods on credit, agrees to accept, the bill being drawn by the seller of goods.

[2] See Draft scheme of the Reserve Bank of India for linking of Indigenous Bankers (26 August 1937).

money market. Bankers' acceptances should be promoted for financing the import trade.[1] Importers should be allowed to take delivery of goods on *hundis* instead of on trust receipts as at present.

The establishment of a well-organized bill market is essential for making our credit structure more elastic and efficient and to supply a corrective to seasonal stringency. The experience in the United States shows that the founding of a central banking organization is followed by the development of a bill market. One may expect a similar happy result here now that the Reserve Bank is established and is authorized to purchase, sell and rediscount bills of exchange (including rupee import bills) and promissory notes endorsed by a scheduled bank or a provincial co-operative bank, and to issue notes against the cover of such eligible paper in the busy season. (See also §§50 and 53.) The marketing surveys, which at present are being conducted by central and provincial marketing officers under the supervision of Mr Livingstone, the Marketing Adviser, may throw further light on the possibilities of extending the use of bills in India.

§30. **Methods of inland remittance.**[2]—In connexion with the movement of crops during the busy season, the question arises as to how the large funds required at different times of the year in different parts of the country are provided. Five main methods of inland remittance may be distinguished: (i) Remittance by *hundis* or cheques; (ii) transfers through the Imperial Bank; (iii) transfers through the Government Treasuries; (iv) transfers of rupees by rail or road; and (v) remittances through the Post Office.

(i) *Hundis or cheques.*—We have already discussed the operations of the shroffs and their *hundi* business, and showed how *hundis* are drawn for remitting money from one centre to another.

We have also referred to the growing popularity of cheques and the part played by the machinery of the clearing houses in facilitating payment by cheques.

(ii) *Transfers through the Reserve Bank and the Imperial Bank.*—Cheap remittance facilities within the country are afforded by the Reserve Bank and the Imperial Bank. The former issues and pays telegraphic transfers and Bank-post bills. The latter purchases demand drafts and pays drafts and telegraphic transfers.[3] Most of the other joint-stock banks also issue banker's drafts on payment

[1] *C.B.R.*, 595-603.

[2] See *Report on Currency and Finance for the years 1935-6 and 1936-7*, Statements xix-xxi for Internal Remittance Statistics.

[3] For particulars regarding the remittances through the Reserve Bank, Imperial Bank and the Government see *Report on Currency and Finance for the years 1935-6 and 1936-7*, Statements xix-xxi.

of a small commission. The Central Banking Enquiry Committee strongly recommend that the cost of internal remittance in India should be reduced as far as possible (par. 157).

(iii) *Transfers through Government Treasuries.*—Though Government Treasuries are primarily maintained for administrative purposes, they usually sell to the public 'Supply Bills' and 'Transfers'[1] drawn upon other treasuries, provided the latter have sufficient funds. A small commission is charged for these facilities. Where no adequate facilities for remittance are available, co-operative banks may be encouraged in their work of inland exchange business by restoring the facilities for free remittance transfer. They may also be given facilities for getting funds by the sale of drafts on the apex bank at district and *taluka* treasuries free of charge.

(iv) *Transfers by rail or road.*—Though the actual transport of specie by rail or road is being gradually superseded by the methods described above, considerable amounts of rupees are still sent by rail to cotton and jute areas to purchase the crops from the cultivators and small merchants who insist on payment in silver coin. Even the ten-rupee note is of too high a denomination for ordinary purposes. 'It so happens that the different harvests are ready to be moved at different times in different parts of India. The cotton crop is moved in December to April in western and northern India, the wheat crop in April, May and June in northern India, and the Burma rice crop in January to April, and the jute crop in August to December.'[2] Silver coin is thus moved many hundreds of miles backwards and forwards between different parts of India during the year. There is, however, now a tendency to replace coin by notes, as shown by the return of rupee coin from circulation.

(v) *Postal remittances.*—Remittances by postal money orders serve a useful purpose so far as small sums are concerned, but they are expensive when the amounts involved are large. A reduction in the rates is therefore desirable. The Post Office has developed a system of setting payments in opposite directions against one another similar to that followed in the case of cheques. Remittance in notes through the Post Office early established its popularity and incidentally led to the adoption of the circle system for the regulation of paper currency.[3]

All these methods help in increasing the fluidity of money and prevent the rates for it at different places from being even more disparate than they actually are.

[1] Ibid.
[2] H. S. Jevons, *Money, Banking and Exchange in India*, pp. 98-9.
[3] *Ante*, ch. vii, §§39-40.

§31. **Utility of central banks.**—The International Financial Conference which met at Brussels in 1920 passed a resolution that 'in countries where there is no central bank of issue, one should be established'. Underlying this resolution is the idea that there is a close connexion between the maintenance of financial stability and a central banking organization. The advice embodied in this resolution has in the last few years been widely followed in European countries and the United States, till lately the home of decentralized banking.[1] In India the opinion had been gaining ground for a long time that a central bank was essential in the country for various reasons. By the force of circumstances the Government had come to take upon themselves important functions, such as note-issue, management of cash balances, regulation of foreign exchanges, etc., and it was felt that these functions were best performed by a central bank. Again, it was a great source of weakness that these functions should be divorced from banking proper. This divorce led to the keeping of two distinct reserves, namely, Government's reserves and bankers' reserves, with ill-defined relations between the two, and it made the monetary system highly inelastic. The absence of a central banking authority further led to a general lack of direction in the banking policy of the country. Though there was the 'multiple reserve' system in theory, that is to say, the various banks kept their own reserves, in practice these reserves were hardly adequate, and the danger was that in a crisis everyone would count upon everyone else. The bank failures of 1913-14 added to the strength of this argument. Other advantages of a central bank would be a moderation of the wide fluctuations of the bank rate and mitigation of its normal high level through an enlargement and co-ordination of the banking resources of the country. The central bank would also provide adequate rediscount facilities, so that the other banks would be in a position easily to liquefy their assets, a facility which would increase their credit. A central bank would further take over from Government officials the responsibility for a variety of financial and semi-financial duties for the discharge of which they were ill equipped. The absence of expert advice and experience in India had resulted in the centre of power in financial matters being shifted to the India Office and the India Council, which, however, were not adequately in touch with conditions in India. The central bank would get over this difficulty by providing trained experience and advice on the spot, and it would also be useful as a buffer between the Secretary of State and public criticism. The introduction of a gold bullion standard in India would impose

[1] See Kisch and Elkin, *Central Banks*, p. 2.

on the currency authority the obligation to buy and sell gold at a fixed parity on demand and to allow the free inflow and outflow of gold. The unlimited obligation to provide gold (or gold exchange) at a fixed price requires that the currency authority should be in a position to check a drain on its gold reserves by raising its rate of discount. On the other hand, if gold is being imported, the currency authority will lower its discount rate. The manipulation of the discount rate so as to maintain currency stability is a function which falls peculiarly within the sphere of a central bank, which is further calculated to help a fuller, wider, and more effective use of the Government balances for commercial and industrial purposes. A central bank would also extend banking facilities by helping the smaller banks and arranging for a continuous reduction of remittance charges from one part of the country to another, to the great benefit of the commercial community. Another advantage is that the central bank would be an instrument for the wider diffusion of sound and reliable banking practice. Lastly, the maintenance of the stability of the purchasing power of money is being increasingly recognized to be a world problem requiring the co-operation of the principal countries of the world. This co-operation would be best attained, if each country equipped itself with an efficient central bank.[1]

§32. **History of the proposal.**—The idea of a central bank for India is almost a century old.[2] As early as 1836, a large body of merchants interested in the East Indies submitted to the Court of Directors a project for a great banking establishment for British India and claimed the following advantages for the scheme: That it would (i) facilitate the use of English capital to finance English commerce; (ii) give stability to the monetary system of India; and (iii) be convenient to the East India Company in connexion with its financial arrangements, especially the management of revenue receipts in India and the remittance of Home Charges. The basis of the Bank of Bengal, it was urged, was too narrow for such a customer as the Government. The definite establishment of the three Presidency Banks put an end to the idea of turning the Bank of Bengal into a Bank of India. The scheme of constituting an all-India bank by the amalgamation of the Presidency Banks came to the front for the first time in 1867, when it was proposed by Mr Dickson, the Secretary and Treasurer of the Bank of Bengal. No practical results, however, followed. In 1898 the idea of a

[1] See Kisch and Elkin, op. cit., pp. 3-5.

[2] For a detailed history of all the proposals for general or state banks in India from 1773 onwards, see O. P. Gupta, *Central Banking in India (1773-1934)*.

central bank was considered in a half-hearted manner by the Fowler Committee. In 1900-1 the question was taken up by Lord Curzon's Government, and although nothing came of it, the Government declared their faith in the desirability of creating a state bank by the combination of the Presidency Banks. In 1912-13 Sir Lionel Abraham of the India Office drew up a memorandum on the subject which was placed before the Chamberlain Commission. Mr J. M. Keynes, a member of the Commission, also prepared an elaborate scheme for a central bank in collaboration with another member, Sir Ernest Cable. The essential features of this scheme were later incorporated in the Imperial Bank Act of 1920. The outbreak of the War led to a postponement of the question till a more suitable opportunity offered itself for its reconsideration. The amalgamation of the three Presidency Banks seemed to be the only practicable basis for the creation of a central bank. The vast extent of their business, their wide experience and established connexions, their long and constant association with the Government and the many uses to which they had been put by the Government, especially during the War, made it impossible to leave them out of any project for a central bank. On the part of the Presidency Banks themselves also there was now a greater willingness—not to say eagerness—than had been shown before, to fall in with the scheme of amalgamation, on account of the fear that, if they did not consent to the plan, pressure of public opinion was likely to force the Government to create a brand-new state bank on purely official lines, and to sever their connexion with the Presidency Banks. Accordingly the Imperial Bank Act was passed in September 1920 and came into effect from 27 January 1921.

§33. **Formation of the Imperial Bank.**—As a basis for the amalgamation, the three Presidency Banks were taken over by the Imperial Bank as 'going concerns' with all their assets and liabilities. Even all of the directors of the old Presidency Banks were continued as members of the local boards of the new bank. In fact the constitution of the local boards was exactly the same as that of the old Boards of Directors. There was no provision fixing the location of the general head office. The Central Board was to meet at least once every year at every local head office. The Legislature apparently preferred to adopt this plan rather than undertake the delicate task of deciding between the claims of the three Presidency towns.

The Imperial Bank is thus a private corporation like the Bank of England or the Bank of France, but it was until the recent (1935) establishment of the Reserve Bank of India also a State Bank in the restricted sense that it was specially created by a

specific Act of the Indian Legislature and was assisted, controlled and supervised by the Indian Government within certain limits. The chief difference between the Imperial Bank and the Banks of England and France was in regard to its very limited functions as a State Bank.

The capital and reserve of the new bank was Rs. 15 crores as against Rs. 7 crores which was the capital of the old three Presidency Banks put together. Of these Rs. 15 crores, Rs. 11·25 crores was authorized capital and Rs. 3·75 crores reserve fund. The authorized capital was divided into shares of Rs. 500 each, the shares being those issued by the new bank. The shareholders of the three Presidency Banks became automatically the shareholders of the Imperial Bank, the shares of the latter being issued in exchange for the shares held in the former. An increase in the capital of the bank was thought to be desirable for greater safety and stability and in view of the more extensive business of the new bank. The increased capital was secured by issuing new shares, the existing shareholders being allowed the right to the allotment of two new shares for every one they held.

§34. **Constitution of the Imperial Bank.**—The control of the Imperial Bank was entrusted to a Central Board of Governors with local boards at Calcutta, Bombay and Madras, and at such other places as the Central Board, with the previous sanction of the Governor-General-in-Council, may determine.

Under the Imperial Bank of India Act of 1920 (which was amended in 1934 in consequence of the enactment of the Reserve Bank of India Act) the Central Board of Governors consisted of (i) Managing Governors not exceeding two in number, appointed by the Governor-General on the recommendation of the Central Board, to hold office during his pleasure; (ii) the Presidents, Vice-Presidents and the Secretaries of local boards as representatives of the shareholders, (iii) the Controller of Currency or some other officer nominated by the Governor-General; (iv) and lastly, not more than four non-officials nominated by the Governor-General-in-Council to represent the interests of the general tax-payer and the public. The Controller of Currency and the Secretaries of the local boards were not entitled to vote. They were only sitting members. The Controller of Currency was the representative of the Government and acted as the guardian of its interests. The Governor-General-in-Council was entitled to issue instructions to the bank in respect of any matter which in his opinion vitally affected the financial policy or the safety of the Government balances. The duties of the Central Board were to deal with matters of general policy, to exercise general powers of control over the local boards, to

determine the distribution of funds and the fixation of the bank rate (which is now called the advance rate), and to be responsible for the weekly publication of the bank's accounts. The local boards on the other hand dealt with the ordinary day-to-day business in their respective territories. For the current general (central) management there was a smaller working body consisting of three members of the Central Board, of whom one was the Controller of Currency. A novel feature was that the bank was allowed by the Act to establish a London office. It was not, however, permitted to deal directly with the public in foreign exchange, though it might transact business in London on behalf of the Indian Government including the Secretary of State, public bodies, other banks and the old customers of the Presidency Banks.

§35. **Functions of the Imperial Bank.**—The Act of 1920 followed the old Presidency Banks Act of 1876 in defining absolutely the class of business in which the bank may engage, though the old restrictions were modified in some minor points, especially in regard to certain limited powers of access to the London money market and dealing in foreign exchange.

The functions allowed to the bank were: (i) investments in certain specified securities of the Government of India and United Kingdom, Port Trust Bonds, certain Municipal Corporation Bonds and those of State-aided railways and of District Boards; (ii) advancing money against any of the above securities; (iii) advancing money against accepted bills of exchange and promissory notes, against goods or documents of title thereto deposited with or assigned to the bank; (iv) drawing, accepting, discounting and selling bills of exchange and other negotiable securities payable in India or Ceylon; and, subject to the direction of the Governor-General-in-Council, the discounting, buying and selling of bills of exchange payable outside India for, from or to such banks as may be approved. The bank was allowed to draw bills of exchange and grant letters of credit for the use of parties whose estates were being administered by the bank and also for private constituents or customers for bona fide personal needs; (v) borrowing funds in India and receiving deposits, receiving securities for safe custody and collecting interest thereupon, buying and selling gold and silver, etc.; (vi) the London office was allowed to borrow money in England for the purpose of the bank's business upon the security of the bank's assets, but was not to open cash credits, keep cash accounts or receive deposits in London except from the former customers of the Presidency Banks. The Act provided for an agreement between the bank and the Secretary of State for India to last for ten years, being terminable thereafter after one year's notice.

§36. **Functions as a public institution.**—The functions of the Imperial Bank as a Government bank were as follows:

(i) The bank undertook all the general banking business of the Indian Government, and accepted payments and made disbursements for the Government. It held all the treasury balances at headquarters and at its branches. (This involved the abolition of the Reserve Treasury System.) (ii) The bank managed the public debt in return for a specified remuneration. (iii) The bank was required to undertake to open 100 new branches, of which the Government of India might determine the location of one in four. Before January 1921, when the Imperial Bank Act came into force, the Presidency Banks had between them 59 branches. To these, 102 new branches were added by 31 March 1926, making a total of 161 branches. Of the new branches, 36 are in places where there was previously no other bank, while 61 of the remaining 66 were opened at places where there was a Government treasury. In all, 89 of the new branches are at places where there is a Government treasury. (iv) The bank was expected to give the public every facility for the transfer of money between its branches at reasonable rates approved by the Controller of Currency. The maximum rate for the transfer of amounts of Rs. 10,000 and over was fixed at one anna per cent (instead of the usual four annas per cent), but recently, in order to assist other banks and to encourage them to effect their transfers through the Imperial Bank, the rate for banks has been reduced to half an anna per cent. The Government were to cease remittance of funds for the public between any two places where the Imperial Bank carried on business. (v) The London office of the bank, which was started in January 1921, took over a portion of the business of the Government of India which was previously in the hands of the Bank of England, for example, the current account of the High Commissioner for India.

§37. **Business prohibited to the Bank.**—(i) The restrictions as to dealing in foreign exchange and raising funds in London in their relaxed and modified form have been already noted. (ii) Loans or advances upon mortgage or otherwise, upon the primary security of immovable property, or the documents of title relating thereto, were expressly prohibited, but allowed against such a collateral (secondary) security if the main security was of the type noted (see §35(i)). (iii) Loans or advances could not be made on the security of its own stock or shares. (iv) The amount which might be advanced to any individual or partnership or firm by way of discount or on any personal security was limited under by-laws sanctioned by the Government. (v) Loans or advances could not be granted for a longer period than six months. (vi) Discounts could not be made,

or advances on personal security given, unless such discounts or advances carried with them the several responsibilities of at least two persons or firms unconnected with each other in general partnership.

§38. **Points of criticism against the Imperial Bank.**—The Imperial Bank as constituted in 1921 was made the target of much adverse criticism. We shall here mention some of these points of criticism. First of all, it was objected that the Imperial Bank was not a genuine public corporation or a State bank. It was a private concern and especially open to suspicion on account of the strong representation of European interests on it which, it was thought, might limit the utility of the bank to Indian commercial and industrial interests. The Imperial Bank had merely perpetuated the old management, the old policies and the old traditions of the Presidency Banks. English management might be unsympathetic and unable to understand the needs of Indian merchants and industrialists. The agents at mofussil branches, being mostly non-Indians, might fail to understand the local needs of the people and no effort be made to cultivate intimate and friendly relations with the shroffs. The bulk of the deposits collected by the branches of the bank were not invested locally but sent to headquarters. The Imperial Bank was further subjected to the criticism which had been raised against European-managed concerns in general, namely that they did not provide for the training of Indians.[1] The scheme of Indian apprentices has not been worked so as to give full satisfaction. The bank has indeed made a beginning in filling responsible posts by Indians, but has not gone nearly as far as it might in this direction. The Imperial Bank has also been freely charged with discriminating against Indian firms and Indian institutions and with showing undue partiality to European firms and European institutions. The representation of Indian interests by the nomination on the Central Board of four non-official Indians under the Act of 1920 was not considered sufficient, and the public demand was that they should be elected by the Assembly. As the Imperial Bank is a private concern, the State was deprived of the profits which it would have derived if it had been a State bank. Nor was there any arrangement for a division of profits between the bank and the State. The prestige and the material assets of the bank, it was argued, depended to a large extent on its connexion with the State, which was therefore entitled to a portion of the profits. The high dividends declared by the bank squared ill with the primary object for which the bank was

[1] See vol. I, ch. xiii, §16.

constituted, namely the promotion of national welfare. The Central Board has been found by experience to be too inactive and wanting in initiative. Moreover, it can at best only lay down a policy, but cannot see it carried out. It has degenerated into a mere board of trustees, each member of which is concerned with watching the interest of his own ward or sphere. There is no action or united impulse to further general welfare on the part of the Board as a whole. The powers of the Board are negative in character and not sufficient to evolve a continuous constructive programme of banking development.[1]

The control of the State over the bank under the Act of 1920 was not as effective as it should have been, as the Controller of Currency was expected to interfere only when Government interests were at stake. The branch banking policy of the bank has not been very successful. Branches have sometimes been established at places where there were already sufficient banking facilities, and this has exposed existing banks to unfair competition at the hands of the Imperial Bank, especially before the establishment of the Reserve Bank in 1935, when the Imperial Bank had special privileges and large command of Government funds.

Another group of criticisms was on the score of the excessively limited functions assigned to the bank and the consequent impairment of its utility. The bank had little real resemblance to the central banks of Europe in relation to the banking and currency functions it performed for the Government. In the case of the other banks, with the exception of the management of the State mint, everything else—for example, the management of the reserves, Government balances and note-issue, etc., is left to the central banks. But in the case of the Imperial Bank, only the cash balances and the duties of a general banking nature were handed over to it. The paper currency, the gold standard reserve and the remittances to England to meet the Home Charges were still managed by the Government. Not having the power of note-issue, the Imperial Bank could not effectively control the money market through the bank rate, as do other great central banks.

The monopoly of the exchange banks and the Government in the field of foreign exchange under the Act of 1920 was left practically intact. The fact that the exchange banks had prospered so well shows that the risky character of the business had been greatly exaggerated. Another restriction imposed on the Imperial Bank was that it could not borrow without security or accept deposits outside India. This was no more than a concession to the jealousy of the exchange banks, which also explains the

[1] cf. K. C. Mahindra, *Indian Currency and Exchange*, pp. 193-5.

exclusion of the bank from foreign exchange business. Borrowing and receiving deposits abroad sometimes might be necessary to ease the situation in the Indian money market. Lastly, the Imperial Bank, though it was intended to be a co-ordinating agency, was far from being a bankers' bank in the strict sense of the term. The other banks did keep their reserves with it, but only to a very limited extent. The result was that the Indian money market remained practically as inorganic as it was before the Imperial Bank was brought into existence.

§39. **The Imperial Bank of India (Amendment) Act, 1934.**—When on the recommendations of the Hilton-Young Commission, the Government of India introduced the Reserve Bank Bill in the Legislative Assembly in January 1927, another bill to amend the Imperial Bank of India Act of 1920 was also simultaneously introduced with the objects of freeing the bank from the restrictions which on account of its hybrid nature were imposed upon it, and of modifying the control of the Government over its operations.[1] It will thus be seen that the Imperial Bank Amendment Bill was consequential on the Reserve Bank Bill, and as the latter had to be postponed *sine die* (see §46) the former could not be proceeded with. When, however, the third Reserve Bank Bill of 1933 was passed in 1934, the Imperial Bank of India Amendment Bill was also passed at the same time as the Imperial Bank of India Act (III of 1934) and received the assent of the Governor-General-in-Council on 6 March 1934. The following are the main changes made by the amending Act:

(i) *Changes in the constitution of the bank.*—The Central Board consists of the following directors: (*a*) Presidents and Vice-Presidents of the Local Boards established by the Act; (*b*) One person elected from among themselves by the members of each Local Board established by the Act; (*c*) A Managing Director to be appointed by the Central Board for five years, who may be continued by the Board for further periods not exceeding five years; (*d*) Such number of persons not exceeding two and not being officers of the Government as may be nominated by the Governor-General-in-Council; (*e*) A Deputy Managing Director to be appointed by the Central Board; (*f*) Secretaries of the Local Boards; (*g*) Such number of persons to represent any Local Boards established hereafter under the Act as the Central Board may prescribe. The Directors specified in (*e*) and (*f*) are not entitled to vote at the meetings of the Central Board. The Deputy Managing Director

[1] O. P. Gupta, *Central Banking in India (1773-1934)*, p. 77. The question why the Imperial Bank of India was not converted into a central bank is discussed in §43 below.

is entitled to vote in the absence of the Managing Director. The Governor-General-in-Council is to nominate an officer of the Government to attend meetings of the Central Board, who is not, however, entitled to vote. Under the new Act the Controller of Currency ceased to be an *ex officio* member of the Board, and the number of persons nominated by the Governor-General is reduced to two. So also the Managing Director is to be directly appointed by the Board. Government control over the working of the bank is thus lessened.

(ii) The Imperial Bank of India, which ceases to be banker to the Government (this position is now occupied by the Reserve Bank), is authorized to enter into an agreement with the Reserve Bank of India to conduct Government business as the sole agent of the Reserve Bank. (This is more fully explained in §56 below.)

(iii) The old limitations imposed on the business of the London office of the bank have been removed. The bank is enabled to establish branches or agencies in India and foreign countries.

(iv) The Central Board is authorized to establish Local Boards without the previous sanction of the Governor-General-in-Council. Similarly the bank is authorized to increase its capital without such sanction. The bank is now freed from the power of the Governor-General to issue instructions to it regarding matters affecting his financial policy or the safety of the Government balances.

(v) *Removal of some of the restrictions on the business transacted by the bank.*—The principal changes are as follows: The bank is now authorized to buy bills of exchange payable out of India, to borrow money out of India and to transact foreign exchange business. The period of advances and loans (as also of bills discounted) relating to the financing of seasonal agricultural operations is extended from six to nine months. The bank is authorized to acquire and hold and generally deal with, any right, title or interest in any property, moveable or immoveable, which may be the bank's security for any loan or advance or may be connected with such security. The bank is further authorized to advance and lend money, and open cash credits on the security of shares of the Reserve Bank, debentures or other securities for money issued under the authority of a municipal board or committee, or with the sanction of the Governor-General-in-Council, on the debentures or other securities for money issued under the authority of a Ruling Prince or Chief, or on debentures of companies with limited liability subject to directions issued by the Central Board. The bank is empowered to make advances and open cash credits against goods which are hypothecated to the bank as security for such advances, loans or credits, if so authorized by special directions of the Central Board.

Some of the old restrictions [e.g. restrictions on land mortgage business, or on the period (with modifications already noticed) of the advances and loans, on the amount of the loans to individual borrowers, prohibition of loans on the security of the shares of the bank, etc.] still continue to operate. These are justified on the ground that the Imperial Bank has been given the privilege of being the sole agent of the Reserve Bank and will in that capacity conduct the Government's treasury business, and hold Government balances. Hence the need for a special Act to regulate the working of the Imperial Bank of India.

§40. **Recommendations of the Central Banking Committee regarding the Imperial Bank.**—The Central Banking Enquiry Committee made the following recommendations regarding the extension of the scope of activities of the Imperial Bank (on the assumption that a separate Reserve Bank would be established): (i) The indigenous bankers should be utilized by the bank as agents for collection of cheques and bills in the same manner as it uses joint-stock and co-operative banks. (ii) It might discount bills of indigenous bankers more freely than at present. (iii) The assistance rendered to co-operative banks in the matter of cash credits and overdrafts should be continued. (iv) Remittance facilities to co-operative banks should be granted on the same terms as for joint-stock banks. (v) It should continue to follow a liberal policy of granting advances against agricultural produce in godowns. (vi) Within safe and proper limits the bank should extend the assistance at present given to industries, on the lines followed by joint-stock banks in Germany. (vii) Under certain conditions it should endeavour to take its proper place among the banks financing the foreign trade of India.[1]

It remains to be seen how far the Imperial Bank, now that it is freed from some of the restrictions imposed by the old Act of 1920, extends its activities, especially in the direction of industrial finance and foreign exchange business. The Bank has established a separate foreign exchange department and is trying to expand its foreign exchange business. It is in a position of advantage in this respect, owing to its London branch, numerous branches in India, extensive business connexions, and large financial resources.

§41. **Financial position of the Imperial Bank.**—The following tables between them give an idea of the nature of the heritage into which the Imperial Bank of India has entered, and afford a synoptic view of its resources and functions.

[1] *C.B.R.*, 526.

(A) Capital Reserve, Deposits and Cash Balances of the Imperial Bank of India

(In lakhs of rupees)

Year 31 Dec.	Paid-up Capital	Reserve and Rest	Public Deposits	Private Deposits	Cash Balances	Investments (Government and other securities authorized under the Act)
1921	5,62	4,15	6,80	65,78	13,60	12,46
1923	5,63	4,55	8,57	74,20	15,01	12,18
1925	5,63	4,92	5,47	77,83	17,47	17,01
1927	5,63	5,24	7,20	72,07	10,89	18,59
1929	5,62	5,47	7,60	71,64	14,00	33,00
1931	5,62	5,14	8,32	63,86	11,04	30,27
1933	5,63	5,49	6,44	74,13	15,60	47,03
1934	5,62	5,66	6,72	74,28	18,97	41,56
1935	5,63	5,76	[1]	79,09	19,59[2]	46,88

(B) Statement of Affairs of the Imperial Bank of India on 22 April 1938

(In thousands)

Assets	Rs.	Rs.	Liabilities	Rs.	Rs.
Investments :—			Capital :—		
Government Securities ...	37,31,27		Authorized — 2,25,000 shares of Rs. 500 each	11,25,00	
Other investments authorized under the Imperial Bank of India Act, 1920 ...	1,03,25	38,34,52	Issued and subscribed — 2,25,000 shares of Rs. 500 each		
Advances :—			Called up — 75,000 shares of Rs. 500 each, fully paid	3,75,00	
Loans	7,05,72		1,50,000 shares of Rs. 500 each, Rs. 125 paid	1,87,50	5,62,50
Cash credits and over-drafts	23,54,47		Reserve Liability of shareholders — Rs. 375 per share on 1,50,000 shares ...	5,62,50	
Bills discounted and purchased	4,92,25	35,52,44	Reserve fund		5,50,00
Liability of constituents for acceptances per contra		5,85	Fixed deposit, savings bank, current and other accounts ...		80,78,20
Dead stock		1,98,49	Loans against securities per contra		—
Sundries		56,51	Acceptances for constituents		5,85
Bullion		—	Sundries		69,18
Cash :—					
In hand and with the Reserve Bank of India	7,36,59				
Balances with other Banks	8,81,33	16,17,92			
		92,65,73			92,65,73

[1] Public (Government) Deposits were transferred to the Reserve Bank of India on 1 April 1935.

[2] Includes balances with the Reserve Bank.

§42. **The question of the Reserve Bank.**—We shall now discuss the question of the Reserve Bank which is proclaimed to be the crowning glory of the new currency and banking system in India. We have already indicated the main functions to be assigned to the new bank, which is expected, among other things, to be a bankers' bank and to unify the control over the banking and currency reserves of the country. The Reserve Bank is calculated to help India 'to move forward towards that financial and economic development with the granting of additional financial and banking facilities for Indian agriculture, Indian commerce, and Indian industry, which has been the theme of one Commission and Committee after another. We shall see the development of a discount market and acceptance business, of increased facilities for the marketing of produce and, in short, a gradual mobilization of India's immense potential capital for the development of India's own resources '.[1] The general case for a central bank has already been stated.[2] Such a bank had been widely desired in India, not only on account of the improvement in banking and currency machinery which it promised, but also because 'the growing political consciousness of the country has led to the search for all national emblems, amongst which a central State bank is one '.[3]

§43. **Case for a brand-new creation.**—The Imperial Bank was intended to serve as a State bank but we have already seen reasons for denying that it filled this position satisfactorily. It performed one or two functions of a true central bank, and there was much debate on the question whether it would not be desirable to turn it into a proper central bank; but the objections to this step were various and overwhelming. In the first place, the Imperial Bank was a private corporation frankly out to earn money. The large number of branches which it had been compelled to start had forced it to become a commercial bank. Commercial banking, however, was incompatible with the position of a real central bank. It was also unfair that the Imperial Bank, with the advantages even greater than under the Act of 1920 which it would enjoy as a central bank, by holding the reserves of other banks and the balances of the Government, should be allowed to enter into competition with other banks not endowed with these privileges. The functions of a true banker's bank are protective and not competitive. Moreover, a large number of branches is not a help but a positive impediment to a bank of issue, which wants branches

[1] Sir Basil Blackett's speech introducing the first Reserve Bank Bill (1927).

[2] See §31 above.

[3] P. Lovett, *The Mirror of Investment*, p. 19.

only at a few important places. If the Imperial Bank were to be converted into a central bank its charter would have to be radically altered so as to deprive it of its functions as a commercial bank. The Hilton-Young Commission also argued that the Imperial Bank had been playing a very useful role in the credit organization of the country, especially since 1920, by establishing branches in various parts of the country, and that it would be unwise to check this useful career by restricting the functions of the bank to those of a central bank. On the contrary, it would be desirable to free the Imperial Bank altogether from the restrictions imposed upon it under the Act of 1920—restrictions which clearly had their origin in the hybrid character of the functions originally assigned to it. With the withdrawal of its central banking functions it would be freer and more competent to perform its important task of spreading banking facilities in India. The Commission, therefore, favoured the establishment of a separate and entirely new central bank and proposed that the Imperial Bank should carry on important agency work for the Reserve Bank. This view was generally endorsed in the country. We have already stated that the Imperial Bank had not succeeded in winning popular esteem and had never been held to be remarkable for the broad national outlook essential for a central bank, and public opinion on the whole was strongly against its metamorphosis into a Reserve Bank. The Central Banking Enquiry Committee also favoured the creation of an altogether new Reserve Bank.

§44. **The Hilton-Young Commission's proposals.**—The Hilton-Young Commission proposed that the Reserve Bank should be a private shareholders' bank. The constitution which they suggested for the Reserve Bank was on the same lines as that of the Imperial Bank, and they considered that, having regard to the large area of the country and its diversity of local conditions, the system of local head offices in the chief business centres, managed by local boards elected by shareholders registered in the respective branch registers, would be the most appropriate. The central as well as the local boards should be independent of the Government and free from all political pressure, and a predominant majority of their members should derive their mandate from the shareholders of the bank by election, only a small minority on the board being nominated by the Government. The presence of Government nominees is indeed necessary in view of the Government's experience in currency matters and the great importance of their banking and remittance business. To eliminate the danger of political pressure, however, the charter of the bank should direct that no person shall be appointed President or Vice-President of a local board, or shall be

nominated a member of the central board if he is a member of the Governor-General's Council, the Council of State, the Legislative Assembly, or any of the Provincial Executive or Legislative Councils.

Detailed recommendations were made about the note-issue, composition and location of reserves, etc., some of which have already been mentioned.[1] So far as the gold and gold security reserve against notes was concerned, the Commission rejected the model set up by the English Bank Charter Act of 1844 as too rigid for Indian conditions in view of the poor development of the cheque currency. They recommended the Proportional Reserve system, under which the notes in active circulation are secured by a minimum percentage of gold or gold securities laid down by statute, which may be transgressed for a temporary period, on the payment of a tax on the deficiency, and with the consent of the Government. The proportional system permits of a far wider expansion and contraction of the circulation than the fixed fiduciary reserve system. There is no greater scope for inflation under this system than under the English system. For under the latter system also, undue expansion of credit can take place through the inflation of the cheque currency. Both systems, in fact, require prudence in the management of currency and credit.

§45. **State bank vs. shareholders' bank.**—In January 1927, the Government introduced a Bill (the first Reserve Bank Bill) framed on these lines proposing a shareholders' bank with a commercial directorate, and a new agreement with the Imperial Bank freeing it from some of its old restrictions. The Bill was referred to a Select Committee in which a sharp difference of opinion showed itself on the fundamental point as to whether the Reserve Bank should be a State bank or a shareholders' bank and as to the constitution of the central board. So far as it is a matter of principle, the widely accepted view is that a shareholders' bank is preferable, and that a central bank should be regarded more as a large public trust than a department of State.[2] It is true that State control is necessary to some extent because the State has its own interests to protect, and, moreover, must be in a position to prevent the bank from degenerating into a purely dividend-hunting concern and ceasing to be a true national institution. However, it is better if possible to start by making the bank an independent organization, keeping for the State such specific and limited powers as may be essential, rather than establish a State bank and then devise machinery to make the bank sufficiently independent of the Government.

[1] *Ante*, ch. viii, §§12-13.

[2] See Kisch and Elkin, op. cit., p. 17.

The very fact of State ownership affords facile pretexts for undue interference on the part of the Government. With reference to the proposal that members of the Legislature in India should select some members of the directorate of the Reserve Bank and should themselves be eligible for becoming directors, it was objected that this would mean the introduction of ' political pressure in its least desirable form—in a party form as well as personal form. For the panel which is to be put forward by the Assembly, . . . would naturally include men chiefly from the dominating party of the day '; and ' through personal and direct action of the party members thus sent on to the Board of Directors, the eddies of political feeling and antagonism would act directly on the policy of the bank '. Such a system would also impose additional heavy work on the Legislature, which is already burdened with more work than it can cope with.[1] The fear of the predominance of large capitalists, especially foreign capitalists, it was pointed out, could be met by the allocation of the bank's shares by preference to small subscribers and to persons of Indian domicile. Another objection to a State bank is that it would tend to be an effete institution excessively dependent on a lead from the Government in everything.

The Majority of the Select Committee, however, objected to a shareholders' bank on the following grounds: that a Reserve Bank in charge of currency and credit ought in the fitness of things to be made responsible to the Legislature; that only a State bank would inspire confidence among the people in India; that a Reserve Bank does not require much capital and therefore there is no necessity of a body of shareholders. The Select Committee attached much importance to the argument referred to above, namely that a shareholders' bank is likely to involve domination of the bank by large capitalists in the big cities.

Regarding the composition of the directorate, the Majority proposed that there should be a board consisting of fifteen governors and one officer, with a majority of Indian elected members including three members elected by the elected members of the Central Legislature, and another three similarly elected to represent agriculture by the Provincial Legislatures. The two directors to be appointed by the Governor-General-in-Council must be Indians as also the Governor and the Deputy-Governor of the bank. Two directors were to be elected by the Associated Chambers of Commerce, and two by the Federation of the Indian Chambers; one director was to be elected by the provincial co-operative

[1] See J. C. Coyajee, *The Reserve Bank of India*, p. 18.

banks. The officer of the Government was to be appointed by the Governor-General-in-Council and was not to be entitled to vote.

§46. **Fate of the first and second Reserve Bank Bills.**—The Bill, as amended by the Select Committee, was taken up by the Assembly in the Simla session in August 1927. The scheme of the State bank was incorporated in the Bill, but agreement could not be reached on the question of the directorate. The Government were defeated on their proposal to disqualify a member of the Legislature from being a director of the bank and the House was strongly against the proposal of the Government to delete the recommendation of the Select Committee that the Governor and the Deputy-Governor must be Indians. Sir Basil Blackett accepted in principle the State bank scheme and the amendment of Mr S. Iyengar that the six directors, instead of being elected by the Legislatures, should be elected by certain electoral colleges and that there should be an Indian majority on the board. Complete agreement not having been reached, Sir Basil brought forward a fresh scheme which appeared to have a fair chance of passing in the Assembly. But the Finance Member sprang a surprise on the Assembly by announcing in September that the Government did not wish to proceed with the Bill during the session as there was no agreement on the question of the directorate. This aroused considerable criticism and it was alleged that the Government of India were acting under instructions from the Secretary of State, who apparently objected to the drastic changes in the original scheme.

After conferring with the Secretary of State, the Government of India decided to drop the old Bill and published a new Bill (the second Reserve Bank Bill) in January 1928, prior to its introduction in the Assembly. The new Bill abandoned the State bank idea and reverted to the shareholders' bank. It provided for a broad-based distribution of the share capital by the issue of shares of one hundred rupees each; limitation of the amount to be subscribed; allotment of specified shares to Bombay; branches at Calcutta, Madras, Rangoon and Delhi; adoption of certain qualifications for shareholders so as to ensure a predominant share of the capital going to persons and companies domiciled in India or registered by Acts of Parliament; and scheduled banks which were to be required to maintain certain minimum reserves with the bank. Members of the Legislatures were to be prohibited from being directors.

The new Bill was ill-fated, and spectacular developments followed when in the Delhi session of the Assembly (1928), the President refused to call upon the Finance Member to move his Bill

on the ground that he could not do so under rules of parliamentary procedure until the old Bill was formally withdrawn or had lapsed. The Government thereupon decided to proceed with the old Bill, the consideration of which they had abruptly postponed in September 1927. With this decision, all the old troubles revived and the opposition was too strong for the Government to be able to push through their proposals regarding the constitution of the board. They therefore announced, on 10 February 1928, that they had no intention of proceeding with the Bill in view of the temper displayed by the House, which seemed to preclude any sort of a workable compromise.

§47. **Subsequent developments regarding Reserve Bank legislation.**—It appeared at one time as if the project would be suffered to lapse altogether. But it was prevented from meeting this fate, thanks to the strong emphasis laid on the early establishment of a Reserve Bank by the Central Banking Enquiry Committee in its Report published in 1931, and to the new importance with which this question came to be invested in consequence of the recommendation of the Federal Structure Sub-committee of the First Round Table Conference to the effect that early effort should be made to establish, on sure foundations and free from any political influence, a Reserve Bank with a view to ensuring confidence in the management of Indian credit and currency. The White Paper on the Indian Reforms, published early in 1933, made it a condition that a Reserve Bank, free from political influence, should be set up by Indian legislation before introducing responsibility at the Centre as regards finance. The proposal was once again scrutinized by the London Committee on Reserve Bank Legislation in July 1933. In the meantime, certain conditions (viz. a stable budgetary position, reduction in the size of short-term debt in London and India, accumulation of adequate reserves and restoration of India's normal export balance) laid down by the Financial Safeguards Committee of the Third Round Table Conference in its Report of December 1932, came to be substantially fulfilled, barring perhaps the last condition, which has so far been only partially fulfilled. The London Committee submitted its Report in August 1933, and the Reserve Bank of India Bill—the third of its kind—drafted in accordance with its recommendations, was introduced in the Assembly (by Sir George Schuster), and in the Council of State on 8 September 1933. The Bill, as amended by the Joint Select Committee of the two Houses, was presented to the Assembly on 15 November and was passed by it on 22 December 1933. The Council of State also blessed it in February 1934 and the Bill became law on receiving the assent of the Governor-General on March 6,

thus successfully negotiating the many difficult hurdles in its way.[1]

§48. **The Reserve Bank of India Act (1934).**—It will be readily admitted that the Reserve Bank of India Act is the most comprehensive and important piece of banking legislation so far placed upon the statute book in India. The preamble to the Act states that it is expedient to start a Reserve Bank for India to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in British India and generally to operate the currency and credit system of the country to its advantage. We shall now proceed to review the main provisions of the Reserve Bank of India Act relating to the constitution and functions of the Bank.[2]

§49. **Constitution of the Reserve Bank.**—(i) *The bank is a shareholders' bank.* The original capital is Rs. 5 crores divided into shares of one hundred rupees each, fully paid up. Separate registers of shareholders are to be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon. The nominal value of the shares originally assigned to the various registers was Rs. 140 lakhs to Bombay, 145 lakhs to Calcutta, 115 lakhs to Delhi, 70 lakhs to Madras and 30 lakhs to Rangoon. Owing to subsequent transfers the distribution of the shares has appreciably altered, and there is a marked tendency towards concentration (especially in the case of the Bombay area), as is shown by the fact that the total number of shareholders has declined from 92,047 on 1 April 1935 to 62,570 on 1 December 1937. During the same period the average number of shares held by each shareholder has increased from 5·4 to 8·0. An amendment of the Reserve Bank Act in order to limit the number of shares that a holder may register in his name to a maximum of 200 shares is at present under consideration.[3]

A shareholder must be domiciled in India and either an Indian subject of His Majesty or a subject of an Indian State, or a British subject ordinarily resident in India, or companies and co-operative societies registered in India, or scheduled banks. Each shareholder has one vote for every five shares subject to a maximum of 10 votes.[4] Shares of the value of Rs. 2,20,000 are to be held by the

[1] For an interesting account of the Reserve Bank legislation the reader is referred to an article in the *Economic Journal* (June 1934), by G. Findlay Shirras.

[2] For a very interesting and instructive commentary on the various clauses of the Reserve Bank of India Act see A. Ramaiya, *The Reserve Bank of India Act*.

[3] *Annual Report of the Reserve Bank* (1937), pp. 3-4.

[4] The procedure adopted in allotting shares is explained in §61 below.

Government for disposal at par to the Directors to obtain the minimum share qualification.

(ii) *Offices, branches and agencies.*—In pursuance of its obligations under the Act, the bank has established offices in Bombay, Calcutta, Delhi, Madras and Rangoon and a branch in London. It may establish branches[1] or agencies in any other place in India and, with the consent of the Governor-General-in-Council, elsewhere.

(iii) *Management.*—The general superintendence and direction of the bank is entrusted to a Central Board of Directors which consists of 16 members as follows : (*a*) A Governor and two Deputy Governors to be appointed by the Governor-General-in-Council after considering the recommendations of the Central Board; (*b*) four Directors to be nominated by the Governor-General-in-Council; (*c*) eight Directors to be elected on behalf of the shareholders on the various registers, two each for Bombay, Calcutta, Delhi and one each for Madras and Rangoon; (*d*) one Government official to be nominated by the Governor-General-in-Council. This official, as also the Deputy Governor, are not entitled to vote. The purpose of employing the Governor-General-in-Council to nominate four Directors is to redress deficiencies, if any, regarding the representation of some important elements in the economic life of the country, such as agricultural interests. A Local Board for each of the five areas consists of (*a*) five members elected by shareholders; (*b*) not more than three nominated by the Central Board with a view to securing the representation of territorial or economic interests not already represented, particularly agricultural interests. The elected members of the Local Board have to elect from among themselves one or two persons, as the case may be, to be Directors representing the shareholders on the register for the area for which the Board is constituted. The Local Board has to advise the Central Board on such matters as may be generally or specifically referred to it and has to perform such duties as the Central Board may by regulations delegate to it. The Local Boards are thus mainly advisory in their nature. No Director and no member of a Local Board can also be a member of the Indian Legislature or of a local Legislature. It will be recalled that the first Reserve Bank Bill came to grief on this issue. No salaried Government official nor an employee of any bank nor a director of any bank other than a co-operative bank may be a Director or a member of a Local Board.

§50. **Business which the bank may transact.**—(i) The bank may accept deposits without interest, from the Government, local

[1] There are branches of the Banking Department at Cawnpore, Karachi and Lahore. The Issue Department has branches at these three places and also at Bombay, Calcutta, Madras and Rangoon.

authorities, banks and any other person. This provision is intended to prevent the Reserve Bank from competing with other banks and is in accordance with central banking practice elsewhere; (ii) the purchase, sale and rediscount of bills of exchange and promissory notes, arising out of bona fide commercial transactions, bearing two or more good signatures, one of which must be that of a scheduled bank, and maturing within 90 days from the date of such purchase or rediscount, exclusive of days of grace. In the case of agricultural bills drawn or issued for financing seasonal agricultural operations or the marketing of crops, the period allowed is nine months, and one of the two signatures has to be that of a scheduled or a provincial co-operative bank. Bills maturing within 90 days since date of purchase, bearing the signature of a scheduled bank, may also be purchased, sold or rediscounted if they are issued or drawn for holding or trading in Government securities; (iii) purchase from and sale to scheduled banks of sterling in amounts of not less than the equivalent of one lakh of rupees; (iv) purchase, sale and rediscount of bills of exchange drawn in or on any place in the United Kingdom provided such business is transacted with scheduled banks. The bank may keep balances with banks in the United Kingdom; (v) it may make loans and advances to States in India, local authorities, scheduled banks, or provincial co-operative banks, repayable either on demand or on the expiry of fixed periods not exceeding 90 days, against trustee securities, gold or silver, eligible paper, promissory notes of scheduled or co-operative banks supported by documents of titles to goods; (vi) the bank may make ways-and-means advances to the Governor-General-in-Council or Local Governments repayable within 90 days; (vii) purchase and sale of securities of the Government of India and the United Kingdom subject to certain maxima; (viii) the bank may act as agent to the Secretary of State or the Governor-General-in-Council, or Local Governments, or local authorities in the matter of purchase and sale of gold or silver, management of public debt, etc.; (ix) it may also make an agency agreement with central banks in other countries; (x) the bank is authorized to borrow money for a period not exceeding one month from scheduled banks or other central banks; (xi) the bank is authorized to issue bank notes subject to conditions mentioned later; (xii) it may generally transact all business incidental to or consequential upon the exercise of its powers and duties; (xiii) it should be noted that the bank is authorized to purchase, sell and rediscount bills of exchange drawn on and payable in India in order to enable the bank to discount rupee import bills in the event of such bills coming into existence in the future, as contemplated by the Central Banking Enquiry Committee; (xiv) the bank is also

authorized to conduct what are known as open-market operations, which have now become an integral part of central banking practice elsewhere. When, therefore, in the opinion of the Central Board it is necessary to regulate credit in the interests of Indian trade, commerce, industry and agriculture, the bank may purchase, sell, or discount eligible paper (bills of exchange and promissory notes) directly in the open market (without the signature of a scheduled or a co-operative bank) or it may make loans or advances, or purchase or sell sterling. The Committee of the Board or the Governor, to whom such authority may be delegated, can exercise such authority only on special occasions (not necessarily amounting to an emergency) and subject to prior consultation with the Central Board except in cases of special urgency. In every case the Central Board must be informed about the action so taken.

§51. **Business which the bank may not transact.**—The bank is prohibited from (i) engaging in trade or having a direct interest in any commercial or industrial undertaking (except by way of satisfaction of its claims); (ii) from purchasing its own shares, or the shares of any other bank, or any company, or from granting loans on such security; (iii) from advancing money on immovable property or from owning such property (except for its own business premises, etc.); (iv) from allowing interest on deposits, and (v) from drawing or accepting bills payable otherwise than on demand. These prohibitions follow central banking legislation elsewhere and are intended to ensure the highest degree of liquidity of the assets of the Reserve Bank.

§52. **Central banking functions.**—The third chapter of the Reserve Bank Act deals with central banking functions.

In the first place, the bank has the obligation to transact Government business, viz. to receive moneys and to make payments, to carry out their exchange, remittance and other banking operations, including the management of public debt. These services are not to be rendered freely, but on terms embodied in agreements. The bank has the right to transact Government (Central and Provincial) business in India and is entitled to receive their cash balances for deposit free of interest (except where the bank has no branches or agencies). The bank must also be entrusted with the issue of new loans.

§53. **Issue of bank notes.**—In the second place, the bank has the sole right of issuing bank notes in British India (and, for a period, currency notes of the Government of India supplied to it by the Governor-General-in-Council). The latter is not to issue any currency notes after this Chapter comes into force. The Issue Department is separated from the Banking Department on the model

of the Bank of England, although the Indian Act prescribes the proportional method of holding reserves and not the English method of a fixed amount of fiduciary issue. The assets and liabilities of the Issue Department are to be kept distinct from those of the Banking Department. This arrangement, while it has the merit of presenting the accounts in the simplest possible form and of inspiring greater confidence in the note issue, has the defect of not showing the bank's liabilities as one comprehensive whole. The denominations of notes are to be 5, 10, 50, 100, 1,000 and 10,000 rupees unless otherwise directed by the Governor-General-in-Council on the recommendations of the Central Board. (Thus one-rupee notes may be issued later.) The bank notes are legal tender and are guaranteed by the Governor-General-in-Council in order to promote greater confidence in the note issue, as recommended by the Hilton-Young Commission. Reserve Bank of India notes were first issued to the public in India in January 1938, when supplies of Rs. 5 notes became available. Rs. 10 notes were issued in February and Rs. 100 and Rs. 1,000 notes in May 1938. The bank has also decided not to issue notes of the denomination of Rs. 50 and Rs. 500 (apparently because their present circulation is negligible) though the Government of India notes of these denominations will continue to be legal tender. Although Burma has been separated from India with effect from 1 April 1937 the Reserve Bank continues to be responsible for the management of currency in Burma. Currency notes of the Government of Burma are now legal tender in Burma only as are also distinctive notes of the Reserve Bank intended for circulation in Burma only.

The assets of the Issue Department shall consist of not less than two-fifths of gold coin, gold bullion, or sterling securities, provided that the amount of gold shall not be less than Rs. 40 crores in value. Of the gold coin and gold bullion, not less than 17/20ths shall be held in British India. The remaining three-fifths may be held in rupee coin, Government of India rupee securities of any maturity, and such bills of exchange and promissory notes payable in British India as are eligible for purchase by the bank, provided that the rupee securities shall not exceed one-fourth of the total amount of the assets or Rs. 50 crores, whichever amount is greater, or with the previous consent of the Governor-General-in-Council, such amount *plus* a sum of Rs. 10 crores. Gold is to be valued at its par value, i.e. 8·47512 grains of fine gold per rupee, rupee coin at its face value, and securities at market rate. Sterling securities are defined as balances at the credit of the Issue Department of the Bank of England, bills of exchange drawn on and payable in the United Kingdom within 90 days, and Government securities of

the United Kingdom maturing within five years (the period may be exceeded for two years after the Act comes into force). It was also laid down that on the date of the transfer of note issue to the bank by the Government of India, and of the transfer of the Gold Standard and Paper Currency Reserves, the gold coin and bullion and sterling securities were not to be less than one-half of the whole amount transferred and the amount of the rupee coin was not to exceed Rs. 50 crores, any surplus over this amount being held by the Government in a separate account. Arrangements are made by which the bank and the Government can keep the rupee coin held in the assets at Rs. 50 crores or one-sixth of the total assets, whichever is greater.

The total value of notes issued increased from Rs. 186,09 lakhs on 1 April 1935 (when the bank was established) to Rs. 215,27 lakhs on 2 September 1938.[1] During the same period, the amount of gold coin and bullion held by the Issue Department of the bank remained practically unchanged at about Rs. 44,42 lakhs, the amount of sterling securities increased from Rs. 48,63 lakhs to Rs. 69,49 lakhs, the amount of rupee coin increased from Rs. 49,99 lakhs to Rs. 68,99 lakhs, the amount of rupee securities decreased from Rs. 43,05 lakhs to Rs. 32,38 lakhs, and the percentage of gold and sterling to total notes issued increased from 50·02 to 52·91.[2]

As in the case of the Federal Reserve and other central banks of the world following the proportional reserve system, the bank is authorized, with the previous sanction of the Governor-General-in-Council, for periods not exceeding thirty days in the first instance, which may, with like sanction, be extended from time to time by periods not exceeding 15 days, to hold as assets gold coin, gold bullion or sterling of less than two-fifths of the total assets. The bank is required to pay a tax on the deficiency during the period of suspension of assets requirements, at bank rate with an addition of 1 per cent per annum when such holding exceeds 32½ per cent of the total assets, and of a further 1½ per cent in respect of every further decrease of 2½ per cent or part of such decrease, provided that the tax shall not in any event be payable at a rate less than 6 per cent per annum. The bank is placed under the obligation to supply different forms of currency. Thus it is required to issue rupee coin on demand in exchange for bank notes and currency notes of the Government of India, and shall issue currency notes or bank notes in exchange for coin which is legal tender. It must

[1] We have already explained the causes of increase in the note circulation in chs. vii and viii.

[2] See *Report on Currency and Finance for the years 1935-6 and 1936-7*, Statement xiv; and monthly *Statistical Summaries* issued by the Reserve Bank.

convert notes of five rupees or upwards into notes of lower value or other coins which are legal tender in such quantities as may in the opinion of the bank be required for circulation. The Governor-General-in-Council shall supply such coins to the bank on demand. Thus in view of the special conditions in India, bank notes have been allowed to retain the same unlimited convertibility into silver rupees which is a privilege enjoyed by the existing Government currency notes.

§54. **Exchange obligations of the Reserve Bank.**—The third central banking function relates to the obligation imposed upon the bank to sell sterling and buy sterling with a view to maintaining stability of the exchange value of the rupee with sterling (provisionally at 1*s.* 6*d.*, pending decision on the best suited monetary standard for India when the international situation has become stable enough to frame permanent measures). We have already dealt with the obligations imposed on the bank by these 'Ratio clauses'. (See ch. viii, §31.) The Reserve Bank Act thus aims at establishing the sterling exchange standard for the time being.

§55. **Scheduled banks.**—In the fourth place, every bank carrying on the business of banking in British India included in the second schedule[1] (i.e. having a paid-up capital and reserves of not less than Rs. 5 lakhs) is required to maintain with the Reserve Bank a balance the amount of which shall not be less than 5 per cent of its demand liabilities and 2 per cent of its time liabilities in India at the close of business on any day. This provision follows in principle §19 of the Federal Reserve Act of the U.S.A. and is intended primarily to enable the Reserve Bank of India to centralize the banking reserves of the country so as to be able to regulate and control the credit position in the country by controlling the total volume of bank money created by member banks. It also serves incidentally to make a partial provision for the liquidity and safety of the deposits of member banks who are also expected to keep in addition sufficient till money.[2] Each scheduled bank must also send a weekly return both to the Reserve Bank and the Governor-General-in-Council showing its demand and time liabilities in India, the total amount of Government of India and bank notes held in India, the amounts held in rupee coin and subsidiary

[1] There are 54 such scheduled banks at present. Their number increased from 50 to 54 during the year 1937. This shows that the advantages of contact with the central bank of the country are being increasingly recognized by joint-stock banks, and some of them increased their share capital, apparently with the primary object of being included in the list of scheduled banks. *Annual Report of the Reserve Bank of India* (1937), p. 14.

[2] See Ramaiya, op. cit., pp. 119-21.

coin, the amount of advances made and bills discounted in India, and the balances held at the Reserve Bank. The following is a consolidated statement of the position of the scheduled banks published by the Reserve Bank of India as at the close of business on 22 April 1938.

Scheduled Banks

	Rs.
1. Demand Liabilities—	
(*a*) In India	123,33,15,000
(*b*) In Burma	5,72,91,000
2. Time Liabilities—	
(*a*) In India	104,94,80,000
(*b*) In Burma	4,77,29,000
3. Cash—	
(i) Currency Notes of the Government of India and Bank Notes—	
(*a*) In India	5,45,95,000
(*b*) In Burma	88,000
(ii) Burma Notes—	
(*a*) In India	29,000
(*b*) In Burma	22,36,000
(iii) Rupee Coin—	
(*a*) In India	69,66,000
(*b*) In Burma	1,25,000
(iv) Subsidiary Coin—	
(*a*) In India	30,51,000
(*b*) In Burma	1,16,000
4. Balances with Reserve Bank	14,15,80,000
5. Advances—	
(*a*) In India	118,84,62,000
(*b*) In Burma	5,34,74,000
6. Bills discounted—	
(*a*) In India	6,80,76,000
(*b*) In Burma	30,21,000

This power of the bank to call for information is intended to give it efficient control of the credit system. Such returns may also be called for from provincial co-operative banks which have transactions with the Reserve Bank, although they are not compelled to keep any portion of their cash with the Reserve Bank. The indigenous bankers, as previously pointed out, are not yet listed as scheduled bankers. The Reserve Bank Act, however, makes it obligatory for the bank to make a report, at the earliest possible date and in any case within three years, regarding the extension of the provisions relating to scheduled banks to persons and firms engaged in the business of banking.

§56. **The Reserve Bank and the Imperial Bank.**—The Reserve Bank has to enter into an agreement with the Imperial Bank of India, subject to the approval of the Governor-General-in-Council, for a period of fifteen years. It will remain in force thereafter

until terminated after five years' notice on either side, provided the Imperial Bank maintains a sound financial position. Under the agreement, the Imperial Bank is to be the sole agent of the Reserve Bank at all places in British India where there is a branch of the Imperial Bank of India in existence at the time the Reserve Bank Act comes into operation and where there is no branch of the Banking Department of the Reserve Bank. The latter is to pay the Imperial Bank for the first ten years a commission on the total of receipts and disbursements dealt with annually by the Imperial Bank on account of the Government. Later, the scale of commission will be revised. In consideration of the Imperial Bank of India maintaining the existing number of its branches, the Reserve Bank will pay to the former annually for the first five years Rs. 9 lakhs, for the next five years Rs. 6 lakhs, and for the next five years Rs. 4 lakhs. The Imperial Bank cannot open any branch in substitution for a branch existing at the time this agreement comes into force, without the approval of the Reserve Bank.

§57. **The Reserve Fund.**—A Reserve Fund is to be created by the transfer to the bank of rupee securities of the value of Rs. 5 crores by the Governor-General-in-Council. (This has already been done.) The maintenance of an adequate Reserve Fund is essential for covering depreciation in the value of assets of the Reserve Bank and promoting general confidence in the solidity of the banking system. After the payment out of the net annual profits (after allowing for bad and doubtful debts, depreciation in assets, etc.) of a cumulative dividend at such rate—not exceeding 5 per cent[1] per annum—on the share capital as the Governor-General-in-Council shall fix at the time of the issue of shares, a portion of the surplus shall be allocated to the payment of an additional dividend on the scale set forth in the fourth schedule subject to a maximum dividend of 6 per cent. The balance of the surplus profits shall be paid to the Governor-General-in-Council, provided that, if at any time the Reserve Fund is less than the share capital, not less than Rs. 50 lakhs, or the whole of the surplus if less than that amount, shall be allocated to the Reserve Fund. This limitation of profits to shareholders is essential as the bank must not become a dividend-hunting concern. It is also fair that the surplus profits should go to the State since they represent largely the profit of the Paper Currency and the Gold Standard Reserves.

[1] A cumulative dividend of $3\frac{1}{2}$ per cent has been initially fixed, having regard to the prevailing low money rates.

§58. **The bank rate, etc.**—The Reserve Bank shall make public from time to time the *standard rate* at which it is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under this Act. The bank has thus discretion to discount agricultural bills at concessional rates below the rate for discounting or rediscounting commercial paper. It should be noted that, unlike this provision of the Act, the practice of the Bank of England is to fix the minimum rate at which it will discount bills of exchange for others than its customers. It is generally fixed above the open market rate.[1]

Auditors.—In addition to the appointment of not less than two auditors elected by shareholders, the Governor-General-in-Council may at any time appoint the Auditor-General or such other auditors as he thinks fit, to examine and report on the accounts of the bank.

§59. **The weekly return.**—The bank is required to make a weekly return to the Governor-General-in-Council, of the account of the Issue and Banking Departments in the prescribed form (Fifth Schedule). It is to be published in the *Gazette of India*. Similarly a copy of the annual accounts is to be submitted to the same authority. It should be noted that the weekly statement of the central bank in each country is regarded as the key to the condition of the money market. We give below the statement of affairs of the Issue and Banking Departments of the Reserve Bank for the week ended on 22 April 1938.

Reserve Bank of India

BANKING DEPARTMENT

Liabilities	Rs.
Capital paid up	5,00,00,000
Reserve fund	5,00,00,000
Deposits :—	
(*a*) Government[2]	15,82,83,000
(*b*) Banks	14,44,62,000
(*c*) Others	56,72,000
Bills payable	9,93,000
Other liabilities	78,13,000
Total ...	41,72,23,000

[1] See W. F. Spalding, *The London Money Market*, pp. 89-90.

[2] Includes £165,900 held in London on account of the High Commissioner converted at 1*s.* 6*d.* to the rupee.

Assets	Rs.
Notes :—	
(*a*) Legal tender in India	29,14,03,000
(*b*) Legal tender in Burma only	11,000
Rupee coin	6,04,000
Subsidiary coin	3,78,000
Bills discounted :—	
(*a*) Internal	75,000
(*b*) External	Nil
(*c*) Government of India Treasury Bills	2,50,000
Balances held abroad[1]	4,86,75,000
Loans and advances to the Government	2,00,000
Other loans and advances	1,00,000
Investments	6,95,96,000
Other assets	59,31,000
Total ...	41,72,23,000

Issue Department

Liabilities	Rs.	Rs.
Notes held in the banking department ...	29,14,14,000	
Notes in circulation :—		
(*a*) Legal tender in India	177,58,76,000	
(*b*) Legal tender in Burma only	7,61,84,000	
Total notes issued		214,34,74,000
Total liabilities ...		214,34,74,000

Assets	Rs.	Rs.
A. Gold coin and bullion :—		
(*a*) Held in India	41,54,53,000	
(*b*) Held outside India	2,86,98,000	
Sterling securities	78,80,70,000	
Total of A. ...		123,22,21,000
B. Rupee coin		58,73,33,000
Government of India rupee securities ...		32,39,20,000
Internal bills of exchange and other commercial paper		Nil
Total ...		214,34,74,000

Ratio of total of A to liabilities: 57·487.

[1] Includes cash and short-term securities.

§60. **Agricultural Credit Department.**—The bank was required to create a special Agricultural Credit Department, the functions of which are (i) to maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Governor-General-in-Council, Local Governments, provincial co-operative banks, and other banking organizations, and (ii) to co-ordinate the operations of the bank in connexion with agricultural credit and its relations with provincial co-operative banks and any other bank or organizations engaged in the business of agricultural credit. It is hardly possible to exaggerate the need for such an organization in an essentially agricultural country like India. This provision follows in principle a similar provision in the Commonwealth Bank of Australia Act. The main difference, however, is that the functions of the Agricultural Credit Department are of a purely advisory character as compared with those of the Rural Credit Department of the Commonwealth Bank of Australia, which has separate funds of its own, partly contributed by the Treasury and partly by the bank.[1]

At the earliest possible time and in any case within three years of its establishment the Reserve Bank was required to make a Report to the Governor-General-in-Council with proposals if it thought fit for legislation under clause 55 (1) (*b*) on the improvement of the machinery for dealing with agricultural finance, and for effecting a closer connexion between agricultural enterprise and the operations of the bank. As we have already seen (§§4, 5), under subclause (1) (*a*) of the same clause, the bank was required to make a report regarding the extension of credit facilities to indigenous bankers.

Accordingly Mr M. L. Darling, C.I.E., I.C.S., was deputed to investigate into the working and present state of the co-operative banks and credit societies, and the part which indigenous bankers play in the rural economy of the country. His Report was completed in May 1935. The Report and the note containing proposals for the constitution of the Agricultural Credit Department were received by the Reserve Bank about the end of June 1935. The authorities of the bank, after examining and considering the proposals, decided to request the Local Governments through the Government of India to collect and furnish to the bank further particulars about co-operative banks, credit societies, and other agencies—e.g. indigenous bankers and moneylenders—engaged in the business of agricultural credit. Since a long time would be required to obtain detailed information as indicated above, the Bank submitted

[1] This question has been more fully discussed in vol. I, ch. x.

to the Government of India in December 1936, a preliminary Report on agricultural credit with a view to enabling the various parties concerned to proceed to a realistic examination of the question without further delay. This was followed by the Statutory Report by the end of 1937. This Report indicates the various directions in which improvements might be made to enable the existing credit agencies, more particularly the co-operative agency, to be of greater use to the agriculturist and the manner in which the Reserve Bank can render assistance.[1] As pointed out by the Reserve Bank, it was not to be expected that the bank would be able to put forward a final scheme within the short initial period of three years, and it is giving continuous attention to these important problems.[2]

§61. **Inauguration and working of the Reserve Bank of India.**— After the passing of the Reserve Bank of India Act (1934), much spade-work had to be done before the Reserve Bank could be formally inaugurated. It was generally understood that the Bank would begin to function with effect from 1 April 1935. Later in the year 1934, the Governor-General-in-Council appointed Sir Osborne A. Smith (then Governor of the Imperial Bank of India) as the first Governor of the Reserve Bank of India, and Mr (now Sir) J. B. Taylor, then Controller of Currency, and Sir Sikandar Hayat Khan, ex-Governor of the Punjab, as the Deputy Governors. A *communiqué* dated 13 December 1934, issued from Delhi, announced the appointments to the first Central Board of the Reserve Bank in accordance with Clause 15 (3) of the Reserve Bank of India Act. The Board issued a prospectus and placed the shares of the new bank on the market between 22 and 25 March 1935. The prescribed share capital of Rs. 5 crores (fully paid-up) was promptly over-subscribed. It is interesting to note that as many as 1,34,558 persons applied for Reserve Bank shares, the face value of the shares applied for being Rs. 9·05 crores as compared to Rs. 5 crores available for allotment between the five share-registers. As the number of applicants applying for five or more shares exceeded the number required, the allotment was decided by casting lots. In no case were more than five shares allotted to any one applicant, and those who applied for less than five shares totally failed to get any allotment.

The Reserve Bank of India was officially inaugurated on 1 April

[1] This question has been more fully discussed in vol. I, ch. x.

[2] See *Annual Report of the Reserve Bank* (1937), also *Preliminary and Statutory Reports* issued by the Agricultural Credit Department of the Reserve Bank (1936 and 1937).

1935 and opened its offices at Bombay, Calcutta, Delhi, Madras and Rangoon. Later, arrangements were made for starting a London branch as provided for by the Act. The bank took over the control of the Issue Department from the Government and the management of the Public Debt and Government accounts from the Imperial Bank of India on 1 April. The assets of the Currency Department were transferred to the Reserve Bank with effect from the same date. On 3 April, the bank started on its career as a central bank by inviting tenders for the purchase of sterling to be remitted to the Secretary of State for India. It commenced sales of Treasury Bills by tender on 16 April. It was not, however, till 4 July that the bank assumed one of its most important functions as a central bank by announcing the first official bank rate of the country (viz. 3½ per cent, reduced to 3 per cent since 28 November 1935). The next step was to establish contact officially with the scheduled banks. This was accomplished on 5 July 1935, the date on which the scheduled banks lodged their statutory deposits with the bank as required by the Reserve Bank of India Act. The elections for the purpose of constituting the Local Boards were held during November 1935. In December 1935, it fell to the lot of the elected members of the Local Board of the western (Bombay) area to elect two Directors to the Central Board to replace the two Directors nominated by the Governor-General-in-Council to represent that area. The first Annual General Meeting of shareholders was held on 3 February 1936. We have already reviewed the arrangements made by the bank for the issue of its own notes in India and Burma early in 1938.

The successful inauguration of the Reserve Bank of India thus fulfils a long-cherished hope and aspiration. India has now come into line with the other civilized countries of the world, and the chain of Empire Banks (those of the Union of South Africa, Australia, New Zealand, India and Canada) is complete. The long and often provoking delays have been a blessing in disguise. In the first place, the frequent discussions that took place after 1925 served to familiarize the people with the principles on which a modern central bank is founded. In the second place, the Reserve Bank of India came into existence under better auspices, when the embers of the old political controversy of 1927-8 had died out and the reserve position strengthened. The External Reserve (i.e. gold and sterling securities) held in the Issue Department of the bank on its constitution exceeded 50 per cent. Since then, as already pointed out, the holding of sterling securities has considerably increased. But the amount of gold and gold bullion has remained unchanged. Although the gold and sterling assets with the bank

today are probably adequate to maintain the existing sterling exchange standard, the bank would be well advised to add to its gold reserve, and thus pave the way for the establishment in India of a gold standard in the future, when the international monetary situation is clarified and becomes stable.

The working of the Reserve Bank of India during the first three years of its existence largely justifies the claim that it has inaugurated a new era of financial stability, banking reform and extension and re-orientation of the money market. It has attained a remarkable measure of success in the orderly flotation of loans for Central and Provincial Governments at very low rates, in the making of remittances to the Secretary of State, in the sale of Treasury Bills and in maintaining the stability of the rupee. It gave valuable advice regarding the incorporation of new provisions relating to banking companies in the Indian Companies Act. It has offered valuable and cheap inland remittance facilities and contributed its mite to the lowering of money rates. It has also given an indirect stimulus to the extension of banking facilities in the country. But it has not so far fulfilled the principal anticipation, namely the development of a bill market in India, as shown by its paltry rediscounting of bills for scheduled and provincial co-operative banks. We have already referred to the difficulties of this problem and pointed out the efforts that are being made by the Reserve Bank to overcome them. We must also point out here that the Reserve Bank has not, so far, succeeded in linking up the indigenous bankers with itself. It is clear that unless this is done, the Reserve Bank can neither effectively stimulate the progress of the bill market nor unify the two main parts of the Indian money market.

Although the Reserve Bank, as it is constituted today, is not a perfect institution and leaves many things desired, it is capable of doing much good to the country. No good purpose is now served by raking up old controversies, and the best plan of action is to get the utmost out of the present bank and to strive steadily to improve it. There is not much exaggeration in the claim put forward by Sir George Schuster that India has been equipped with the mechanism for the control of currency and credit on the lines approved of by modern experience, and worthy of India's place among the civilizations of the world. There is, however, room for several improvements, which it may be hoped will be effected in the near future. In this age of planned economy a well-equipped, powerful and efficient central bank is a *sine qua non* for a well-ordered economic development of a country like India which is still comparatively in a backward economic condition. It is

clear, however, that a great deal will depend upon the traditions and conventions which the bank will set up and the manner in which it will carry out its national trust.

§62. **Industrial finance.**[1]—One of the great lacunae in the Indian economic structure is the absence of a properly organized system of industrial finance. The banks in Germany play a very important role in satisfying the financial requirements of industries. They provide the greater part of the initial capital for industries, which is subsequently placed among the investing public. In order to distribute the risk it is a very common plan for several banks to join together in a *Konsortium* and pledge themselves to accept a certain portion of the issue. This investment of banks in shares of industrial companies is, however, not a long-term investment as in the case of industrial banks proper but is regarded as a safe investment of the bank's resources in first-class securities, which the banks expect to hold only for a short time. The banks themselves stand to benefit by these transactions since they are useful for acquiring business connexions and extending their influence. Industrial companies in Germany desirous of procuring new capital normally do so through banks with whom they are in permanent banking relations in the manner indicated above. It must, however, be remembered that the banks employ only a limited portion of their resources in industrial finance and that ordinary banking business constitutes their major activity. The Central Banking Enquiry Committee declare themselves in favour of an attempt to eliminate the Managing Agency system and to depend for future development more on the establishment of direct friendly relations between industrial companies and commercial banks. They commend the adoption of the German system with suitable modifications, and suggest that a beginning in this direction might well be made by the Imperial Bank (after the Reserve Bank came into being) and the other commercial banks of established reputation. Besides much experience and wisdom, this class of business would require considerable capital and firm resistance against the temptation to speculate in the creation and sale of securities, and very few of the existing banks at present possess these qualifications.[2] In spite of these limitations of the situation as it exists in India, considerable financial assistance is capable of

[1] This section is based on *C.B.R.*, 385-419 and should be read together with vol. I, ch. xiii, §12.

[2] Dr P. S. Lokanathan in his recently (1935) published book, *Industrial Organization in India* (pp. 251-2), points out the difficulties in the way of the adaptation of Indian commercial banking to the mixed banking of the Continental type. It would certainly be unwise to ignore them.

being rendered to industries if the leading banks were to take a genuine and sympathetic interest in industries. With a view to creating an atmosphere of mutual confidence, while at the same time preventing entanglements incompatible with sound banking, the German model should be copied by banks in India. A useful liaison between themselves and the industries receiving their assistance could be established by appointing Managing Directors or Managers of banks as Directors of industrial concerns. The banks should also establish local Advisory Committees to help them in assessing the financial position of their clients and to carry an assurance to the latter of fair and sympathetic treatment.

While valuable results may be expected from the co-operation of commercial banks as outlined above, the needs of industrial development are not likely to be adequately met by this method alone. Under the new constitution the development of industries within their respective territories is one of the functions which is vested in the Provincial Governments. For a satisfactory discharge of this function it may be useful to establish Provincial Industrial Corporations, with branches, if necessary, and working with capital initially or permanently supplied by the Provincial Government concerned. These corporations should aim particularly at assisting enterprises which are likely to be of benefit to the public, add to the productive power of the province and provide employment for its people.

The Industrial Corporation should obtain its share capital as far as possible from the public, the Government taking such portion as cannot be raised by public subscription. The share capital of the Corporation should be supplemented by debenture capital not exceeding, at the outset, twice the amount of the share capital. The Government might purchase (if necessary) a portion of debenture issues until a regular market is created for them, and also offer a limited guarantee of interest on debentures. The Industrial Corporation should specialize in the provision of long-term capital to industries, which should continue to obtain their working capital from existing institutions. The Corporation may take long-term deposits for not less than two years, loans from these deposits being given for a similar period. The Government should be entitled to be represented on the Board of Directors of the Industrial Corporation during the continuance of Government interest and liability.[1]

An All-India Industrial Corporation may also be established if desired by the Federal or Central Legislature. There are and

[1] *C.B.R.*, 402-7.

will be certain industries of a national character, or so important that their development must be regarded as falling within the functions of the Federal or Central Government and not of the Provincial Governments. Further, the latter might themselves desire such an institution so as to establish direct connexion with the large spending departments of the Central Government as well as direct correlation for the industries as a whole with railway rates, customs, stores purchase and other policies of the Central Government. Pending the formation of an All-India Industrial Corporation, the Provincial Corporations might, for matters of common interest, combine into a Central Association. Legislation on the lines of the Madras State Aid to Industries Act should be enacted in other provinces to provide credit facilities to new and nascent modern industries, or cottage industries. Any Government assistance in regard to provision of capital under such legislation should be given through the Provincial Industrial Corporation where one has been established.

§63. **New scheme of industrial finance in the United Provinces.**—As pointed out in Chapter I, the Government of the United Provinces received the approval of the Provincial Legislature in June 1936 for their scheme for the flotation of a company as a state-aided private enterprise for industrial credit. The broad outline of the provisional scheme is as follows: The Credit Company may be called the Industrial Credit Company or Banking Corporation. Its subscribed capital may be about Rs. 30 lakhs, and its paid-up capital about Rs. 15 lakhs. It may supplement its own capital by raising long-term deposits and loans. It will also have the power of issuing debentures. The Company may have a Directorate of six or seven members, some of whom may be nominated. The Government's sanction may be necessary for the appointments of the manager and other superior staff. The Company may establish branches at important mofussil centres and may set up local committees at such centres. The Government's assistance may be given in the following forms: (i) dividend on paid-up capital may be guaranteed at a specified rate, (ii) interest on debentures issued with the Government's consent may be guaranteed at a specified percentage, (iii) subsidy towards the expenses of management. The maximum rate of interest normally chargeable to industrialists will be prescribed. The maximum rates of dividend may also be limited.

As previously pointed out, the scheme for the Marketing and Financing Company is linked to that of the Credit Company, the latter underwriting its capital of Rs. 5 lakhs. The Marketing Company will not only market the goods on a consignment basis

and do general *arathia* (commission) work, but will also make small advances for raw materials or against finished goods left with the Company for sale. The Government's assistance to the Company may take the form of an annual subsidy and contribution towards the cost of educative propaganda, publicity, advertisement, etc.

The scheme outlined above is the first notable attempt in India to place industrial finance on a sound footing with the help of the State and as such will be watched with great interest.[1]

§64. **The hoarding habit.**—The habit of hoarding to which the Indian people are supposed to be addicted in an unusual degree has long been the subject of comment among European economists. The description of India as a bottomless sink of precious metals is well known. With reference to the supposed insatiable hunger of India for gold and silver, it has been picturesquely observed that ' the precious metals are taken out of the earth by one coloured race and put back into it by another coloured race '. It is likewise said that gold once passed into general consumption in India is permanently lost to the rest of the world. Until recently, Europe has contemplated the steady absorption of the precious metals by India with amused wonderment not unmixed with satisfaction. If India had not swallowed up the gold and silver, the output of which had been enormously increased owing to the discoveries in recent times of new mines and improvements in the methods of extraction, a great derangement in the economic life of European countries would have been caused by a heavy rise in prices. But latterly Europe has been showing distinct signs of alarm and consternation at the prospect of the Indian ' sink ' continuing to perform its age-long function with habitual thoroughness. In 1924-5, when England and other countries of Europe were struggling to stabilize their currencies, India, entirely unmindful of the needs of Europe, added no less than £50 millions worth of gold to her hoards, which was perfectly shocking.[2]

[1] The Government of Bombay have recently (April 1938) appointed a committee to carry out an economic and industrial survey of the Bombay Presidency and to report among other matters on the measures which the Government can undertake to promote economic development within the presidency and to suggest methods for financing them.

[2] This contention has lost much of its force owing to the export from India of over Rs. 318 crores worth of gold between September 1931 (when the rupee was linked to sterling at 1*s.* 6*d.*) and the end of July 1938. See *ante*, ch. viii, §29. On the other hand, considerable gold hoarding has been taking place in the U.S.A. and several European countries in recent years.

The Indian hoards have been variously estimated. Probably the earliest estimate was that of H. D. Macleod, who was the first economist to get the Indian hoards on his brain. He tormented himself with the belief that the Indian hoards must be no less than £300 millions. Lord Curzon estimated them at Rs. 825 crores, while Arnold Wright, writing in the *Financial Review of Reviews*, December 1916, put them at £700 millions. Mr E. L. Price is inclined to accept a recent estimate of the American Trade Commissioner, namely £1,000 millions. Mr Francis Skrine thinks that even this is very much of an underestimate.[1] Sir James Grigg recently (September 1938) referred to a tentative estimate given in the annual Report of the Bank for International Settlements for 1934-5, according to which the gold hoarded in India from 1493 to 1930 amounted to at least Rs. 1,454 crores. So that, with every fresh calculator, the calculations have proceeded in a regular *crescendo* movement.

In complaining of India's consumption of gold and silver, European writers have often seemed to impute a double dose of original sin to the Indian people, and this apparent attempt 'to fasten on India an exceptional and invidious responsibility for the consumption of gold'[2] has provoked heated retorts. Some of these retorts are of the *tu quoque* variety. It is not India alone, it is pointed out, that is addicted to the consumption of gold. The United States absorbed nearly £500,000,000 worth of gold from 1916-23[3] and with two-thirds of the monetary gold supply concentrated in New York and Paris the passion for hoarding can scarcely be regarded as an Indian monopoly. A good deal of the gold in these centres is no doubt concentrated in the central banking reserves, and if a similar use of it has not been possible in India, is it not the faulty currency system (the gold exchange standard) which was prevalent for a long time in India that is at least partly answerable for this? Those who bewail the hoards of India generally forget that part of the gold absorbed by India is used for industrial and domestic purposes, and, as Sir Stanley Reed remarks: 'Every country in the world uses gold and silver for industrial and domestic purposes, and it induces a sense of angry injustice to find that the Indian demand for the precious metals for precisely the same purposes is perverted into senseless hoarding.' Considering that India has a population amounting to about a fifth of the total population of the world, her annual (pre-War)

[1] See Gubbay, op. cit., pp. 23 and 38.

[2] Memorandum of Sir Stanley Reed to the Babington Smith Committee.

[3] Wadia and Joshi, op. cit., pp. 388-9.

consumption of about 20 per cent of the world's output of gold cannot be regarded as disproportionate or excessive.[1]

And when once it is granted that the Indian demand for gold and silver is not abnormal, all things considered, this acquits India of any particular responsibility for hindering the currency stabilization in other countries. If India's legitimate demand for the precious metals is embarrassing to other countries, the latter must and will in course of time devise currency systems less dependent on gold than they have been in the past. It is also possible that India may in course of time take her share in any general world-wide movement for economizing the available supply of gold, but she resents the suggestion that she is in a special sense responsible for the scarcity felt by other countries.[2]

All that has been said above aims at showing that the amount of hoards in India, properly so called, is generally grossly exaggerated. It would, however, be flying in the face of facts to deny the existence of hoards altogether. India has undoubtedly been a very large absorber of gold for non-currency uses, and her present stocks of the metal immobilized by being hoarded must be very considerable.

It need scarcely be pointed out that this is by no means a sign of wealth and prosperity. The hoards are, for the most part, held in endless, scattered, individually insignificant amounts and, moreover, being turned away from productive uses, they are more properly regarded as a cause of poverty than as an index of prosperity.

It is a moot point whether it is permissible to regard gold and silver ornaments as constituting part of the hoards to the extent of their full value, though it is usual to assume them as such. But there seems to be no reason why jewellery worn for purposes of personal adornment should be looked upon as hoarding any more than gold used, let us say, for stopping teeth. Both are forms of

[1] It is sometimes urged in explanation and justification of the large imports of gold into India that they are after all due to India's favourable balance of trade, caused by the keen demand for her goods on the part of her foreign customers. This contention, however, appears to us to be of little value. It must be remembered that India is as anxious to sell, as foreign countries are anxious to buy, her goods, and if gold is sent to her in settlement of her trade balance it is because she prefers it to other commodities.

[2] As suggested above, the outcry at the present moment is principally against the United States and France, and their policy of burying enormous quantities of the world's annual supply of gold in the vaults of their central banking institutions, instead of using the gold for increasing the volume of currency and credit.

consumption of wealth rather than of saving. It is no doubt true that when people in India turn gold and silver into ornaments, they generally do so with the double object of personal adornment and holding wealth in store against a rainy day.[1] All the same it is necessary to distinguish between the two motives, and the precious metals can be regarded as hoards only in so far as they are intended to be stores of value.

Whether the Indian people are not inordinately fond of ornaments and jewellery and whether they do not invest a disproportionate amount of their earnings in them is a question which falls into the same category as a similar doleful inquiry which may be made, for example, with reference to the English workman asking whether he is not more fond of beer than is good for him and whether he would not benefit more by spending his money in other ways. Both are questions relating to intelligent and well ordered consumption. The spread of the banking habit is no more a cure for misguided expenditure on ornaments than it is a cure for misguided expenditure on drink (though, of course, in so far as ornaments are regarded as substitutes for banks, provision of banking facilities will tend to diminish the investment in ornaments). The Indian peasant indeed often spends money on ornaments for himself and for his wife, when perhaps he ought to spend the money on a mosquito net or on more and better food. The use of gold and silver is in some cases forced by custom and plays an important part in social ceremonies sanctioned by religion and tradition. These are regrettable facts, but to remedy them we must rely on the development of a better sense of values as well as on the softening of the rigour of social and religious custom through education and the progress of general enlightenment. But it must be clearly understood that this aspect of the matter is concerned with better or worse modes of consumption and expenditure and has nothing to do with hoarding proper, the underlying idea of which is saving.

When all the allowances suggested by the considerations advanced above are made, there still remains a certain residuum for which the proper name, it must be admitted, is hoarding. Having granted that the evil does exist to some extent we must now proceed to analyse its causes. We have more than once referred to the faulty system of currency as a contributory cause. But the principal cause is found in the numerous invasions to

[1] The Babington Smith Committee also call attention to the practical consideration that a woman, whether Hindu or Moslem, who possesses gold and silver ornaments, or coins converted into ornaments, is entitled to hold them as her personal property.

which India was subjected in the past and the continued misrule and insecurity of life and property from which she suffered. The habit that was contracted in times of insecurity has continued to survive in times of well established peace and security. The present obstacles in the path of reform are the illiteracy of the population and the absence of adequate banking facilities. Recent reports of the Controller of Currency have been commenting with satisfaction on the welcome decline in the import of gold in the last few years. During 1926-7 and 1927-8, the average net imports of gold were only Rs. 1,875 lakhs as compared with an average of Rs. 2,815 lakhs for the five pre-War years. In 1928-9 the net imports were Rs. 1,422 lakhs, which meant a drop of practically one-third when compared with the previous year. Since 1931 there has actually been a large net export of gold from India. This, together with the great success of recent Government loans, indicates a certain welcome increase in the investment habit; but only the fringe of the problem has, as yet, been touched, and for its complete solution we must look to widespread education and a much greater extension of banking facilities. The question of tempting the hoards into productive employment has latterly assumed a new importance. For though it may be true that the absence of a sound currency has encouraged the habit of hoarding, it is also true, on the other hand, that unless the hoards come out, it would be difficult for any currency system, however well devised, to function satisfactorily. For example, if hoarding persists, the control of currency and credit in the best possible way by the currency authority would present insuperable difficulties. The extension of banking, which is suggested as a cure for hoarding, is itself rendered difficult by hoarding. For how can banks carry on, if people will not put their money into them? But the other question is equally pertinent, namely, how can people put money into a bank, if there is no bank to put it into? It is thus a case of action and reaction, and the only remedy is to create as many credit institutions as possible and as great a variety of them as possible to suit the different needs and tastes of the people, leaving education and continuous propaganda to do the rest.

§65. **Fighting the hoarding habit.**—Various suggestions have been made for improving the present banking organization and fighting the hoarding habit. Some of them taken individually may appear trifling, but the combined effect of all of them is bound to be very considerable. We shall mention some of these suggestions:

(i) The Post Office is a ubiquitous agency and it should be utilized to its utmost capacity for promoting the investment habit.

The work it is already doing in this field has been noticed above and some improvements have been suggested. Other suggestions are that (*a*) the interest on Post Office five-years' cash certificates might be allowed to accrue after the first and each subsequent quarter instead of the fourth as at present; (*b*) the limit of the total amount of cash certificates in the case of joint holders, banks and co-operative societies may be raised from Rs. 10,000 to Rs. 20,000; (*c*) the Savings Bank pass books should be bilingual, one of the languages being English, and the other the principal language of the part of the province in which the head office of the issue is situated; deposits by means of cheques should be permitted as well as operating on the Savings Banks accounts by cheques; (*d*) increased facilities should be afforded by the Post Office to investors for the purchase and sale of Government securities and for their safe custody.

(ii) According to the Hilton-Young Commission's suggestion gold certificates should be introduced as soon as feasible.

(iii) The Bihar and Orissa Banking Committee recommend special Women's Cash Certificates which would be called Stridhan Certificates, and which would be issued to women only at perhaps a rate slightly higher than the current rate of interest.[1]

(iv) The Government, as well as municipalities and local bodies, should make and accept payment by cheque as far as possible.

(v) National Savings Associations on the lines of those started in England should be formed for promoting thrift and for familiarizing the small saver with safe and profitable modes of investment.

§66. **Extension of banking facilities.**—Compared with other civilized countries, the number of banks in India is wholly inadequate to the real needs of the country. On 31 December 1935 there were only 285 head offices with 974[2] branches of banks, including agencies, throughout the whole of India. There were in 1928 only 339 towns in the whole of India served by either a bank or branch or an agency of a bank. This number of 339 against the total number of 2,300 towns strongly emphasizes the need for speeding up the expansion and progress of commercial banking in this country.[3]

[1] Sir B. N. Mitra, speaking before a gathering of students at Bangalore, exhorted them to make their sisters understand that 'every ounce of precious metals they discarded would enable them to forge a link for the golden necklace of economic independence round the neck of their motherland'.

[2] These branches were distributed as follows: 8 offices and branches of the Banking Department of the Reserve Bank, 163 branches of the Imperial Bank, 95 of the Exchange Banks, and 708 of the Indian joint-stock banks.

[3] *C.B.R.*, 569.

The following table[1] gives an interesting comparison of banking facilities in different countries, in the pre-depression period.

Banking offices in India and in Foreign Countries on 31 December 1924

Name of Country	No. of Banking Offices	No. of Banking Offices per Million of Population	No. of Banking Offices per 2,700 sq. miles
United Kingdom ...	11,976	285	362
United States ...	30,000	256	20
Japan	7,465	92	80
Canada	4,883	448	3
India	596	2	1

Taking later figures we find the relative situation has remained much the same. For example, there were in the United States of America over 22,071 banking institutions in 1931 with capital and reserves amounting to Rs. 3,541 crores and deposits of Rs. 13,788 crores. The corresponding figures for the United Kingdom in 1932 were 12,557 institutions, Rs. 316 crores capital and Rs. 3,226 crores deposits. In India there were only 1,259 banking offices (including branches and agencies) in 1935. The total bank deposits in the same year were Rs. 2,45 crores, of which 76 crores were deposits in exchange banks. As Sir M. Visvesvaraya points out, the average per capita banking deposits were in the United States Rs. 1,123; in Canada Rs. 804; in the United Kingdom Rs. 698; in Japan Rs. 215 and in India Rs. 6-4-0.[2]

While it is clearly necessary to multiply banking institutions, it is also necessary to start diverse types of them. Joint-stock banking of the ordinary kind may not always be found to be suitable for Indian conditions. Other more suitable models which might be tried are furnished by the popular co-operative banks in Germany and Italy. These popular banks keep the shares as low as possible in order to encourage the small investor. Also the dividend is limited sometimes by law and sometimes by custom. Special terms are offered to poor investors as an encouragement to saving, and loans are advanced at low rates. Loans are also given on personal credit for objects approved of by the banks. Institutions of this kind are likely to flourish in India more than

[1] Presidential Address of Principal M. L. Tannan, Indian Economic Conference, Calcutta, 1927.

[2] Sir M. Visvesvaraya, *Planned Economy for India* (1934), p. 189.

the usual kind of joint-stock banks.[1] It is now for the Reserve Bank of India wisely to guide banking progress in this country.

It is gratifying to learn from the last (1937) Annual Report of the Reserve Bank that branch banking is developing in India on an increasing scale. During 1937 the total number of branches, pay offices, etc., of the scheduled banks increased from 828 to 1,138, while in the previous year the total rose from 723 to 828. It is obvious that much further progress in this direction will be necessary before India can have a network of joint-stock banks adequately covering the country.[2]

§67. **Institute of Bankers for India.**—As we have already seen, one of the reasons for the bank failures in 1913-14 was the generally prevalent ignorance of modern banking in India. The Indian Institute of Bankers, which was registered at Bombay under the Indian Companies Act on 20 April 1928, is calculated to remedy this defect in some measure. The main objects of the Institute are: (i) to support and protect the character, status and interests of persons engaged in or connected with the business of banking generally and especially in India, and consider all questions affecting them; (ii) to encourage the study of the theory of banking and for that purpose to institute a scheme of examinations and grant of certificates, scholarships and prizes; (iii) to spread information on banking and kindred subjects by means of lectures, discussions, periodicals, books, correspondence with public bodies or individuals, etc.; (iv) to collect and circulate statistics and other information relating to the subject of banking in India.[3]

The examinations held by the Institute have already become established. The Institute also conducts a journal. The lectures delivered under its auspices in Bombay and Calcutta have attracted large and appreciative audiences. The facilities for the study of banking, such as they are, are at present confined to the Presidency towns. As funds permit, the Institute should endeavour to extend them up-country by means of correspondence courses, branch libraries, local lectures and colleges. The Central Banking Enquiry Committee recommend that the Institute should make arrangements for University lectures and courses of instruction at different centres, in the subjects included in its curriculum.[4]

[1] See Gubbay, op. cit., pp. 29-32.

[2] *Annual Report of the Reserve Bank* (1937), pp. 15-16.

[3] See *Memorandum and Articles of Association of the Indian Institute of Bankers*, 1928.

[4] *C.B.R.*, 761.

CHAPTER XI

FINANCE AND TAXATION

§1. **Introductory observations.**—Indian finance has in recent years undergone remarkable—almost revolutionary—changes, most of which are directly or indirectly traceable to the War. Before the War there was only one budget for the whole of India, and the Provincial Governments had no independent powers of taxation. The Central Government was the only taxing authority (unless we also take into account the very limited powers of taxation enjoyed by local bodies). Since the War there has been a practically complete separation of Provincial from Central finance. A considerable change has also been going on for the last half a century or so in the relative position of the different sources of revenue. In the course of this period the land revenue has lost its old over-shadowing importance and other sources of revenue have come into greater prominence.[1] The financial system of India has been recently coming more and more into line with other modern systems, as shown by the increasing variety of her taxes and the growing reliance on direct taxes like income-tax. Another great change has been with regard to the position of railways in Indian finance, and we have already noticed their evolution from bloodsucker to milch-cow.[2] Opium, which not long ago used to make a brave show on the revenue side of the budget and was second in importance only to land revenue, has suffered almost a total eclipse as the result of India's great essay in philanthropic finance, and the small Budget revenue shown under this head since

[1] 'The land revenue which was the mainstay of the Government 40 years ago (1883-4), contributing 53·15 per cent of the whole receipts, now (1923-4) contributes only 20·75 per cent. On the other hand, customs has advanced from less than 3 per cent to over 24 per cent, and the income-tax from 1·32 per cent to 12·30 per cent. The share borne by excise (including salt duty) has fallen from 25·07 per cent to 21·67 per cent, partly owing to the reduction in the salt duty and partly no doubt to the drastic action taken in connexion with the intoxicants. The shares borne by stamp duties, including probate duties (about 10 per cent) and local taxation have been more consistent.' —*Report of the Indian Taxation Enquiry Committee*, par. 496. In calculating these percentages the Committee have not taken into account the total revenues of India, but only the total receipts under the heads of taxation, including therein also local taxation.

[2] The milch-cow ran dry during the years of depression, see ch. v, §15.

1935 is derived from excise on opium sold for consumption in India.

§2. **Classification of Indian revenues.**—Indian revenues can be classified according to the authorities charged with the power of levying the taxes from which they are derived, as Provincial, Central and Local (Revenues of Municipalities and Local Boards). Another classification as good as any other is the following:[1]

(i) *Land Revenue.*—We have already dealt with the question whether land revenue is a rent or a tax, and seen that there are more reasons for calling it a tax than a rent.[2] If this view is accepted, land revenue would be a direct tax like income-tax. But since in this controversy absolute certitude is unattainable, it would perhaps be better to cut the Gordian knot by regarding land revenue as a class by itself. (ii) *Taxation Revenue.*—Under this head we have the usual sub-classes of direct taxes and indirect taxes. The income-tax and other assessed taxes and the land cesses included under provincial rates are instances of the former. The salt tax, excise, customs, stamps and registration are the principal indirect taxes in India. (iii) *Public monopolies.*—This head includes the revenue from forests and opium. (iv) *Commercial services.*—Railways, irrigation, public works, posts and telegraphs. (v) *Miscellaneous receipts.*—Payments from Indian States, departmental receipts, etc. (vi) Interest on loans given to local bodies, Provincial Governments and Indian States.

§3. **General statistics of revenue.**—As a preliminary to the discussion of revenue we give below the principal heads of revenue, Central and Provincial, in the year 1936-7.

[1] See K. T. Shah, *Sixty Years of Indian Finance* (second edition), pp. 214-15.
[2] See vol. I, ch. xii, §28.

GENERAL STATEMENT OF THE REVENUES OF INDIA (CENTRAL AND PROVINCIAL) IN 1936-7 [1]

(In thousands of rupees)

Heads of revenue	Central	Provincial
Principal Heads of revenue—	...	
Customs	53,57,51	...
Taxes on Income	15,33,51	3,73
Salt	8,81,36	2,00[2]
Opium	47,66	...
Land Revenue	17,42	31,71,13
Excise	38,70	14,98,52
Stamps	39,00	11,49,44
Forests	14,81	4,25,20
Registration	1,14	1,16,91
Payments from Indian States ...	73,92	...
Scheduled Taxes	...	53,84
Total ...	80,05,03	64,20,77
Railways (net receipts)	32,68,66	1,42
Irrigation (net receipts)	−5,65	9,94,64
Posts and Telegraphs (net receipts) ...	93,36	...
Interest (Debt Services)	40,29	1,65,52
Civil Administration	1,03,36	6,22,49
Currency and Mint	1,18,71	...
Civil Works	31,38	2,33,75
Miscellaneous	96,57	1,89,98
Military Receipts	5,22,26	...
Miscellaneous adjustments between Central and Provincial Governments	−4,90,75	4,90,75
Extraordinary Items—		
Extraordinary Receipts	67	1,14,34
Transfers from Revenue Reserve Fund ...	...	...
Total ...	67	1,14,34
Total Revenue ...	1,17,83,89	92,33,77[3]

[1] *Finance and Revenue Accounts of the Government of India* (1936-7), Tables 5 and 8.

[2] Represents the Provincial Governments' share of additional import duty on foreign salt.

[3] Includes Rs. 10,992 revenue in England.

§4. **History of the customs tariff.** (*A*)—*Pre-War Import Tariff.*—Until recently (1924), the Indian tariff had been on a scrupulously conscientious free trade basis. This involved very moderate import duties. Before the Mutiny there was an import duty of 5 per cent on finished goods and 3½ per cent on raw produce. Goods imported in foreign ships had to pay double the ordinary scale of duties till 1848. After that date the nationality of the shipping was ignored, though differential duties continued to be levied up to 1859 in accordance with the nationality of the goods, being double the ordinary rate on non-British goods. On account of the financial stringency which followed the Mutiny, this distinction was abolished and the general rate was raised to 10 per cent. It was reduced to 7½ per cent in 1864 and 5 per cent in 1875. And eventually in 1882 all customs duties were abolished under pressure from the British Government inspired by the Manchester interest and in spite of the opposition of the then Viceroy, Lord Northbrook.

Between 1882 and 1894 there were thus practically no import duties. But in 1894 owing to financial stringency caused by the falling rupee a 5 per cent *ad valorem* general import duty was imposed. Cotton yarn and piece-goods, and certain other goods, however, were excluded from the operation of the tariff.

Between 1899 and 1904, certain countervailing duties were imposed on bounty-fed sugar coming from Germany, Austria, Denmark and so forth. These were subsequently removed, the last duty of the kind being cancelled in 1912. Their only effect was to divert the import trade in sugar from Germany and Austria to other countries like Mauritius and Java where the system of bounties did not exist.

The only other important changes in the pre-War period in the import tariff were effected in 1910-11, when, to compensate for the loss of the revenue from opium and to meet additional expenditure, higher import duties were levied on silver bullion or coin, and petroleum.

At the end of 1894 it was decided to levy a 5 per cent import duty on cotton fabrics and yarn, but to propitiate Manchester, a duty of 5 per cent was levied on yarns of 20 counts and above produced in Indian mills. This excise on yarn did not give full satisfaction to Lancashire, and therefore, in 1896, the import duty on cotton piece-goods was lowered to 3½ per cent and an excise duty at the same rate was placed on all Indian mill-woven cloth; cotton yarn, whether foreign or local, being altogether exempted from any duty.

This measure was bitterly resented in India. The excise duty

seemed to injure India without benefiting Manchester. As was pointed out by Sir James Westland, 94 per cent of the cotton manufactures of India were outside the range of any competition with Manchester, being of coarser qualities (24s. and under). Manchester had an absolute monopoly of the finer qualities of goods and the bulk of its trade consisted of piece-goods of counts about 30 or somewhat finer, and India could only produce goods of counts 26 or over in small quantities and under difficulties. Lastly, the reduction of the import duty from 5 to 3½ per cent would benefit the richer consumers of foreign cloth, while the home excise of 3½ per cent would affect the poor consumer adversely. The case against the excise duty appeared unanswerable. But, as was wittily remarked by an Indian member of the Imperial Legislative Council, so long as Lancashire sent sixty members to Westminster, the British Government would always have sixty good reasons for maintaining the duty, and thus the duty remained, in spite of continued opposition on the part of the people, till it was finally abandoned in 1926.

(*B*) *Pre-War Export Tariff.*—The history of the export tariff in the pre-War period can be more briefly disposed of.

Until 1860, export duties were an integral feature of the early tariff policy and were levied generally at the rate of 3 per cent *ad valorem* on practically all exports. Though the duties were low and solely for revenue purposes, the principle of export duties was regarded as economically unsound and likely to do injury to the export trade by encouraging foreign competition. Accordingly a consistent policy of abolition was pursued from 1860 to 1880, so that at the latter date only the export duty on rice was allowed to remain. In 1903, a trifling duty was levied at the request of the Indian tea industry on the export of tea.[1]

§5. **War and post-War customs tariff.**—Extensive changes in the customs tariff were introduced during the War and the post-War period which are briefly summarized below.

(*A*) *Import Duties.*—The general *ad valorem* duty was raised to 7½ per cent in 1916-17 (cotton piece-goods however, were not raised to 7½ per cent till 1917-18); to 11 per cent in 1921-2 (including cotton piece-goods); and to 15 per cent in 1922-3 (cotton goods remaining at 11 per cent). Railway materials were taxed at 2½ per cent in 1916-17, and the tax was raised to 10 per cent in 1922-3. Iron and steel were raised from 1 per cent to 2½ per cent in 1916-17, and to 10 per cent in 1922-3. Sugar was increased from 5 to 10 per cent in 1916-17, and from 15 per cent to 25 per cent in 1922-3.

[1] See vol. I, ch. vi, §7, 11(ii).

Machinery and stores for cotton-spinning and weaving were taxed at 2½ per cent in 1921-2, but exempted later on. A high specific duty on matches at 12 annas per gross boxes was imposed in 1921-2 instead of the 7½ per cent *ad valorem* duty. This duty was doubled in 1922-3. Luxury goods like motor cars, cinema films, watches, silk piece-goods, etc., were raised from 7½ per cent to 20 per cent in 1921-2 and 30 per cent in 1922-3. The duty on motor cars was reduced from 30 to 20 per cent and that on tyres was reduced from 30 to 15 per cent in 1927-8, in accordance with the recommendation of the Taxation Enquiry Committee, which stressed the importance of encouraging motor transport in India. The reduction in the duty left a wider margin for Provincial taxation on users of motor cars for the improvement and development of the Provincial systems of road communication. The tobacco duties were raised to 75 per cent *ad valorem* for cigars and cigarettes in 1922-3. In 1927-8 the duty on unmanufactured tobacco was raised from Re. 1 to Re. 1-8 per lb. A 5 per cent duty was imposed on foreign cotton yarn which had been free since 1893. We have already noticed recent changes regarding foreign cotton yarn as also the raising of the revenue duty in 1930 on cotton piece-goods from 11 per cent to 15 per cent *ad valorem* and the imposition of an additional 5 per cent protective duty for three years on non-British goods (British plain grey goods came under the category of goods required to pay a minimum duty of 3½ as. per lb.).[1] A duty of one anna per gallon was put upon kerosene and petroleum, with a corresponding excise duty on the home products. The duty on imported liquors was increased in 1921-2 and again in 1922-3.

In 1930, the silver duty of 4 annas per oz. was re-imposed (it had been abolished in 1920). The Finance Act of 1930 introduced an all-round increase in the import duty on sugar. Those grades of sugar on which the duty was so much per cwt. had to pay Re. 1-8 more per cwt.; where the duty was *ad valorem*, the total burden was a composite duty of 25 per cent *ad valorem* plus Re. 1-8 per cwt.

The acute economic depression and heavy deficits in the Central Budget in recent years led to further heavy and extensive increases in the import duties to provide additional financial resources. For example, the Finance Act of 1931 (March) introduced the following changes which fall into two classes: (i) increases in the substantive rates, and (ii) additional impositions of the nature of surcharges. Under the first category the following principal changes may be noticed: (*a*) The duties on ale, beer, cider and

[1] See *ante*, ch. ii, §§10-13 for these and subsequent changes in the cotton textile duties.

other fermented liquors were increased by about 66 per cent above the old level; while those on wines and spirits (excepting denatured spirit) were raised by 30 to 40 per cent. (*b*) Duties on all grades of sugar and sugar candy were raised by Re. 1-4-0 per cwt., bringing the total import duty to Rs. 7-4-0 per cwt.,—a rate proposed by the Tariff Board in order to give protection to the sugar industry.[1] This increase was a provisional measure for securing additional revenue pending the consideration of the Board's recommendations. The Sugar Industry Protection Act was passed in February 1932. (*c*) The duty on silver was raised from 4 annas to 6 annas per ounce. (*d*) Spices and betel-nut and cinema films were transferred from the general 15 per cent *ad valorem* rate of duty to the 'luxury' rate at 30 per cent. In the second category, come the following main surcharges: (*a*) A surcharge of 2½ per cent was imposed on articles bearing 10 per cent duty, (*b*) 5 per cent on articles bearing 15 per cent or the general rate of duty, (*c*) 10 per cent on articles liable to 30 per cent or 'luxury' duty, (*d*) other important surcharges were 15 per cent on cigars, Re. 1-8-0 per 1,000 on cigarettes, 12 annas per lb. on unmanufactured tobacco, 9 pies per gallon on kerosene,[2] 2 annas per gallon on motor spirit, 10 per cent on motor cars and motor cycles, 2½ per cent on artificial silk yarn and thread, 7½ per cent on silk mixtures, Rs. 2 per ton on imported cement. A surcharge of 5 per cent was also levied on the basic duty of 15 per cent on cotton piece-goods.[3]

The Supplementary Finance Act of 1931 (November) effected further increases in the import duties as follows: (i) Import duty of 6 pies per lb. on raw cotton, (ii) of 10 per cent on machinery, (iii) 10 per cent on dyes, (iv) Rs. 7-4-0 on brown sugar, (v) 15 per cent on artificial silk yarn, (vi) 40 per cent on artificial silk piece-goods and electric bulbs, and (vii) a surcharge of ¼ of the existing rates on all customs imports including surcharges imposed by the preceding Finance Act and also new duties except those on raw cotton, machinery and dyes. The results of these heavy increases have not been altogether satisfactory and in certain cases a tendency towards diminishing returns is in evidence, i.e. a more than proportionate reduction in the volume of the import trade, though this is undoubtedly also due partly to the severe trade depression.

[1] See vol. I, ch. vi, §7, 1(vii).

[2] The excise duties on kerosene and motor spirit were also raised corresponding to the increased import duties.

[3] In addition to these changes certain protective duties were also imposed, for example, on imported salt, wheat, iron and steel and galvanized sheets, and gold and silver thread and wire.

The Indian Tariff (Ottawa Trade Agreement) Amendment Act of 1932 gave effect to the Ottawa Trade Agreement of July-August 1932. On the part of India this Agreement involved the grant to the United Kingdom of a 7½ per cent preference on certain classes of motor vehicles and a 10 per cent tariff preference on certain other classes of goods, there being a special arrangement for iron and steel goods. The Tariff Amendment Act made necessary changes in Schedule II to the Indian Tariff Act, 1894, with effect from 1 January 1933. The articles subject to the preferential rates of duty are included in two new parts, VIII and IX, to Schedule II. Part VIII contains all the articles, formerly dutiable at the general revenue duty of 25 per cent *ad valorem*, but now liable to the standard rate of 30 per cent and the preferential rate of 20 per cent for British goods. Part IX contains all the articles on the preferential list which were formerly dutiable at special rates. The necessary preference has been provided for either by raising the previous rate all round or partly by raising and partly by lowering it, the standard rate having in no case gone beyond 50 per cent *ad valorem*.

The Indian Finance Act of 1934 changed the duty payable on cigarettes to 25 per cent *ad valorem*, and in addition either Rs. 8-2 per 1,000 cigarettes or Rs. 3-4 per lb. whichever is higher. It also increased the duty on unmanufactured tobacco to Rs. 3-4 per lb. (standard rate) and Rs. 2-12 per lb. (Colonial Preference rate). These changes were made necessary by the fact that under the old arrangements the duty on cigarettes was paid doubly as it were, the usual import duty on tobacco plus the surcharge on cigarettes, with the result that certain foreign tobacco-manufacturing interests set up factories in India to avoid paying the double duty. Such a development had not been expected and no claim to protection could be sustained in the circumstances. The same Finance Act also reduced the import duty on silver by 2½ annas, i.e. to 5 as.

The Finance Act of 1935 further reduced the duty on silver to 2 as. per ounce to discourage smuggling and to remove a possible obstacle to the revival of trade in the white metal. At the same time the excise duty on silver was reduced to correspond with the reduced import duty. But the Finance Act of 1937 increased as a revenue measure the import duty, and correspondingly also the excise duty on silver to 3 as. per ounce.[1]

(*B*) *Export Duties.*—In 1916-17, two new export duties were levied on tea and jute. In the case of tea the export duty was fixed at Re. 1-8. This duty was abolished in 1927-8 but its abolition was accomplished by an increase in the income-tax assessment on the

[1] Changes in the protective duties on sugar are reviewed in vol. I, ch. vi. See also §7.

profits on the tea industry. In the case of jute, the export duty was fixed at Rs. 2-4 per bale of 400 lb., being approximately equivalent to an *ad valorem* duty of 5 per cent. Manufactured jute was charged at the rate of Rs. 10 per ton on sacking and Rs. 16 per ton on hessians. In 1917-18, the export duties on jutes were doubled. In October 1919, a 15 per cent *ad valorem* duty was levied on raw hides and skins as a measure of protection to the Indian tanning industry. The subsequent history of the duty and its reduction to 5 per cent have already been noticed.[1] The Finance Act of 1930 reduced the export duty on rice by one quarter, that is, from 3 annas to 2 annas 3 pies a maund, to meet the world fall in the price of rice and to put Burma on an equality with Siam —Burma's principal competitor in the trade—and as an act of justice and help to the Burmese cultivator.

The Finance Act of 1934 abolished the export duty on raw hides since the export trade in hides, especially with Germany, had been dwindling. The removal of the duty was expected to arrest this tendency. The Finance Act of the following year (1935) abolished the export duty on raw skins in order to assist the general revival of the export trade. The arguments in favour of retaining these duties in the interest of the Indian tanning and leather industries have already been noticed.[2]

The War and post-War years have thus witnessed the most striking changes in the customs tariff. The needs of War finance and the post-War financial deficits have called into existence a marked tendency of greater and greater reliance on customs duties. The growth of revenue (Receipts *less* Refunds) from customs from 1913-14 to 1937-8 is shown below.

Growth of Customs Revenue

Year	Crores of rupees	Year	Crores of rupees
1913-14	11·13	1929-30	51·28
1918-19	18·18	1930-1	46·81
1921-2	34·41	1931-2	46·44
1922-3	41·35	1932-3	51·96
1923-4	39·70	1933-4	45·72
1924-5	45·75	1934-5	46·78
1925-6	47·78	1935-6	46·73
1926-7	47·38	1936-7 Budget	46·90
1927-8	48·21	1936-7 Revised	44·78
1928-9	49·28	1937-8 Budget	42·60[3]

[1] *Ante*, ch. ii, §23. [2] ibid.

[3] Exclusive of the Central excise duties, which were estimated at Rs. 7·16 crores. The estimate for customs also excludes Rs. 51 lakhs due to the transfer of an additional 12½ per cent jute export duty to the Provinces and Rs. 4,26 lakhs due to the separation of Burma with effect from 1 April 1937.

All these changes effected under the stress of financial stringency have changed the nature of the customs duties and the position occupied by them in the Indian fiscal system. A high general duty, wide breaches in the principle of uniformity, a curtailed free list, special taxes on articles of luxury, and lastly, the imposition of new export duties, are among the more important features of the new tariff as contrasted with the pre-War tariff.

Till 1924 these changes in the tariff (except as regards the export duty on raw hides and skins) were governed by revenue considerations only. Some of the duties were, however, so high as to produce a definitely protective effect. We have already noted how this strengthened the case for a properly thought out system of protection in place of the haphazard protection which had thus come to be introduced. Since the passing of the Steel Protection Act of 1924, several frankly protectionist duties have been imposed. As a result of the Ottawa Trade Agreement and the enactment of the Indian Tariff (Ottawa Trade Agreement) Amendment Act of 1932, the Indian Tariff has ceased to be a single-decker one and is during the currency of that Agreement characterized by tariff preferences for certain classes of goods imported from the United Kingdom, the Crown Colonies and Protectorates, thus differentiating between imports from different countries.

As regards the incidence of the increased customs duties, the Taxation Enquiry Committee[1] found that there was an increase of customs revenue from Rs. 430 lakhs in 1913-14 to Rs. 1,746 lakhs in 1924-5, i.e. 307 per cent in the case of articles of direct consumption consumed by the population as a whole; while in the case of articles mainly consumed by the richer classes the increase was from Rs. 400 lakhs to Rs. 1,416 lakhs, or by 254 per cent. The Committee observe that, so far as these figures go, they tend to indicate a certain amount of shifting of the burden from the richer classes to the general population. The 25 per cent duty on sugar seems to have been chiefly responsible for this, as it had the effect of raising the price of country as well as imported sugar, and thus of increasing the burden of taxation on the poorest classes who are large consumers of both kinds. Such must also be the general effect of the increases of the duties on imports, not only of sugar but also of cotton goods and silver (1930 and 1931) and the increased excise on kerosene introduced by the Finance Act of 1930. The additional import duties and surcharges imposed

[1] See *Report of the Taxation Enquiry Committee*, par. 145.

by the Finance Acts of 1931 (March and November), as also the levy of excise duties on sugar and matches by the Finance Act of 1934, have a similar tendency. The reduction in the import and excise duties on silver in 1934 and 1935 has, however, given limited relief to the consumer of silver in India.

§6. **Abolition of the cotton excise duty.**—Throughout all the successive increases on imported cotton goods, the excise duty, as will have been noticed, remained at the same old level of 3½ per cent. This paved the way for a complete abolition of this hated impost. In March 1925 the Legislative Assembly passed a Resolution in favour of the abolition of the duty and refused the grant for the excise staff. The depressing situation of the Bombay cotton industry led to a decision on the part of the millowners to reduce the wages of the mill hands by about 11½ per cent. A labour deputation waited on the Viceroy in August 1925 and protested against the cut, asking at the same time for an abolition of the cotton excise. This was followed by a millowners' deputation which urged the same measure. On 16 September 1925, Sir Purshotamdas Thakurdas' Resolution was passed in the Assembly, praying for the suspension of the duty. In November, the Government issued an ordinance suspending the duty, which was finally abolished on 1 April 1926.

§7. **New excise duties on sugar and matches.**[1]—In the Budget Session of the Assembly (March 1934) two new excise duties were levied with effect from 1 April 1934. The Sugar (Excise Duty) Act, 1934, imposed on (i) *khandsari* sugar and (ii) all other sugar, except palmyra sugar produced in a factory in British India, an excise duty of (i) 10 as. per cwt. and (ii) Re.1-5 per cwt. respectively.[2] This new excise duty was justified on the ground that it was needed to fill the gap in the revenue caused by the greatly reduced imports of sugar in consequence of the grant of protection supplemented by the surcharge imposed by the Supplementary Budget of 1931. The development of the sugar industry in recent years, it was argued, had been very rapid and there was a danger of overproduction owing to the unhealthy but uncertain stimulus given by the surcharges, which were in excess of the protection required by the home industry. The excise duty was intended to counterbalance the surcharge and to replace the loss of revenue.

[1] The excise duties on kerosene, motor spirit and silver have already been noticed.

[2] The Provinces where white sugar is produced are to receive an amount equivalent to 1 anna per cwt. out of the proceeds of the sugar excise duty for assisting the co-operative societies among cane-growers so as to help them in securing fair prices. See also vol. I, ch. vi, §7, 1(vii).

On the other hand, the new sugar excise duty was opposed by certain members of the Assembly on the ground that it was inconsistent with the Government's policy of protecting the home industry and that its imposition within two years of the adoption of that policy would handicap the progress of the Indian industry. In order to meet the deficiency of customs revenue caused by a further drop in sugar imports and textiles, the Indian Finance Act, 1937, raised the excise duty on *khandsari* sugar from 10 as. per cwt. to Re. 1-5 per cwt. and on sugar other than *khandsari* or palmyra, from Re. 1-5 per cwt. to Rs. 2 per cwt. This change involved a change in the import duty on sugar, which was fixed at the rate at which the excise was leviable on sugar other than *khandsari* or palmyra, *plus* Rs. 7-4 per cwt., the substantive protection to which the industry was entitled. The excise duty on *khandsari* sugar was reduced to Re. 1 per cwt. in pursuance of Clause 10 of the Sugar (Excise) Order, 1934.

The Matches (Excise Duty) Act, 1934, imposed, on matches made in British India and sold in boxes or booklets containing on an average not more than eighty, an excise duty of (i) Re. 1 per gross of boxes or booklets if the average number is 40 or less, (ii) Re. 1-8 if the average number is more than 40 but less than 60 and (iii) Rs. 2 if the average number is more than 60. In exercise of the powers conferred by the Act the rate of excise duty on all other matches was fixed at 4 as. for every 1,440 matches or fraction thereof. The Act also revised the customs duties on imported matches in such a manner as to comprise rates which maintained the existing measure of protection to the Indian industry over and above the equivalent of the new excise duty. This was justified by Sir George Schuster on the ground that it was necessary to enable the Government of India to recoup their losses caused by granting a half share in the jute export duty to the jute-growing Provinces (Bengal, Assam and Bihar). It was maintained that Bengal, which had been suffering from successive budget deficits since 1930, badly needed help from the Central Government, and that this policy was also in accordance with the recommendation of the White Paper on Indian Constitutional Reform (1933). The proceeds of the match excise, as also of a similar duty imposed by Indian States, were to be credited to a common fund, the Indian States being given a share in proportion to the consumption of matches in their territory on a population basis. Burma was to be given a refund of Rs. 18 lakhs since it had already imposed a match excise of its own. The purpose to which the duty was to be ultimately put, viz. to assist Bengal, evoked criticism from some Provinces that they were being penalized for having managed their

finances better than Bengal. The match excise duty 'has also created a precedent for refunds to Indian States of a tax levied by the Government of India on an article of universal consumption, which is bound to raise awkward issues in regard to the customs revenues '.[1]

§8. **History of income-tax.**—Income-tax in India has a very long and chequered history. A general income-tax (from which agricultural incomes were not exempt) was first levied to meet the financial burdens of the Mutiny, for five years, at the end of which it ceased to operate in 1865. In 1867 another Act was passed imposing a license-tax on professions and trades, excluding agriculture, which continued to be levied till the end of 1872-3. No further taxation was imposed till 1877, when a license-tax was levied on traders and artisans to meet a portion of the Famine Insurance Grant, and Acts were passed in 1878 for this purpose for the United Provinces, the Punjab, Madras, Bengal and Bombay. These Acts remained in force until 1886. The license-tax of 1878 was, however, converted into a general income-tax by the Income-tax Act of 1886 applying to all India. Under this Act, all sources of non-agricultural income were taxed and were divided for this purpose into four classes: (i) salaries and pensions; (ii) profits of companies; (iii) interest on securities; and (iv) other sources. On all annual incomes between Rs. 500 and Rs. 2,000 derived from salaries and interest on securities, a tax of 4 pies in the rupee was levied; while on incomes over Rs. 2,000 and on all profits of companies the tax was 5 pies, there being no further gradation of the tax. Similar incomes derived from other sources were taxed at practically the same rates, charities and religious endowments being exempted. In 1903, the favourable condition of the finances permitted exemption from the tax of incomes between 500 and 1,000 rupees.

The yield of the income-tax before the War was very small, being only about Rs. 3 crores. The richer classes escaped too lightly and did not bear their legitimate share of the burden of taxation. As a result of the increases effected during and since the War (see §9 below) the yield increased to over Rs. 22 crores in 1921-2. But since the rates were further raised in 1922 the country has passed through a serious and prolonged industrial depression, and the yield of the tax decreased from Rs. 18·49 crores in 1923-4 to Rs. 15·42 crores in 1927-8. Later it slightly improved as a result of the substantial increases in the rates of income-tax and super-tax. But as a result of economic depression, the improvement has fallen short of the estimates and has not

[1] See K. T. Shah, *Review of Indian Finance* (*1927-34*), p. 36.

been commensurate with the increases in the rates and the levy of surcharges. The yield of the income-tax exclusive of the small share given to the Provinces was Rs. 17·13 crores in 1933-4, 17·54 crores in 1934-5, 17·07 in 1935-6, 15·30 in 1936-7 (revised) and 14·30 crores in 1937-8 (Budget) after allowing for a loss of Rs. 1·40 crores due to the separation of Burma from 1 April 1937.

§9. **Changes in income-tax during and since the War summarized:—**

1916.—Scale of progression introduced in the ordinary income-tax.

1917.—A super-tax in addition to the ordinary income-tax on a progressive scale was introduced.

1918.—The machinery of income-tax was amended and improved.

1919.—(i) The free minimum income was raised from Rs. 1,000 to Rs. 2,000 a year. (ii) Excess War-profits-tax was levied for a year on incomes in excess of Rs. 30,000, agricultural incomes, incomes of professional classes and public servants being exempted.[1]

1920.—Abolition of the Excess War-profits-tax. Amendment of the Super-Tax Act in regard to profits of companies and registered firms.

1921.—The scale of progression both in the ordinary income-tax and the super-tax revised and raised.

1922, 1930, 1931 (March) and 1931 (November).—A further revision of both the kinds of taxes in an upward direction, including the levy of surcharges and the lowering of the free minimum income to Rs. 1,000 (November 1931).

1933, 1935 and 1936.—Reduction in the income-tax rates on smaller incomes and in the surcharges (1935-6) and the raising of the free minimum income to Rs. 2,000 (1936).

Present rates of ordinary income-tax under the Indian Finance Act of 1938 (March)

A. In the case of every individual, Hindu undivided family, unregistered firm and other associations of individuals not being a registered firm or a company—

	Rate per rupee
(1) When the total income is less than Rs. 2,000	Nil
(2) When the total income is Rs. 2,000 or upwards, but is less than Rs. 5,000	six pies

[1] The Government proposed to take half of the excess profits, which were defined as the difference between the profits returned in 1918-19 and the average of the profits returned in the two pre-War years and the first two years of the War. Incomes below Rs. 30,000 were exempted from the tax.

	Rate per rupee
(3) When the total income is Rs. 5,000 or upwards, but is less than Rs. 10,000	nine pies
(4) When the total income is Rs. 10,000 or upwards, but is less than Rs. 15,000	one anna
(5) When the total income is Rs. 15,000 or upwards, but is less than Rs. 20,000	one anna and four pies
(6) When the total income is Rs. 20,000 or upwards, but is less than Rs. 30,000	one anna and seven pies
(7) When the total income is Rs. 30,000 or upwards, but is less than Rs. 40,000	one anna and eleven pies
(8) When the total income is Rs. 40,000 or upwards, but is less than Rs. 1,00,000	two annas and one pie
(9) When the total income is Rs. 1,00,000 or upwards	two annas and two pies

B. In the case of every company and registered firm, whatever its total income; two annas and two pies in the rupee.

The Supplementary Indian Finance Act passed in November 1931 lowered the exemption limit by taxing incomes between Rs. 1,000 and Rs. 1,999 at 2 pies in the rupee in the financial year 1931-2 and at 4 pies in the rupee in the following financial year 1932-3. The same Act imposed a surcharge of $\frac{1}{8}$ of the existing rates of income-tax in the financial year 1931-2 and $\frac{1}{4}$ of the existing rates in the next financial year. The rate of income-tax on incomes between Rs. 1,000 and Rs. 1,499 was reduced, as desired by the Assembly, from 4 pies to 2 pies by the Indian Finance Act of 1933 (March). A further reduction was effected in March 1935, the rate on incomes between Rs. 1,000 and Rs. 1,499 having been reduced to one and one-third pies and that on incomes between Rs. 1,500 and 1,999 to two and two-third pies. At the same time the surcharge was reduced by one-third. The surplus budget for 1936-7 made possible a further reduction by half of the surcharges on income-tax. At the same time (March, 1936) the exemption limit was once again raised to Rs. 2,000 to the great relief of a large number of small income-tax payers. It is to be hoped that the remaining surcharges, which constitute a burden on trade and industry, will be taken off without further delay.

These are the rates of the ordinary income-tax. In 1916 the highest rate was 12 pies on Rs. 25,000 and above. In 1921, it was 16 pies on Rs. 40,000 and above. In 1922 the maximum rate was raised to 18 pies on Rs. 40,000 and above, and to 19 pies in 1930. It was raised to two annas and two pies on Rs. 1,00,000 and above in 1931 (March).

The present rates of super-tax under the Finance Act of 1938 (March)

In respect of the excess over Rs. 30,000 of total income—

	Rate per rupee
(1) In the case of every company—	
(a) In respect of the first Rs. 20,000 of such excess	Nil
(b) For every rupee of the remainder of such excess	one anna
(2) (a) In the case of every Hindu undivided family—	
(i) In respect of the first Rs. 45,000 of such excess	Nil
(ii) For every rupee of the next Rs. 25,000 of such excess	1 anna and 3 pies
(b) In the case of every individual, unregistered firm and other association of individuals not being a registered firm or a company—	
(i) For every rupee of the first Rs. 20,000 of such excess	9 pies
(ii) For every rupee of the next Rs. 50,000 of such excess	1 anna and 3 pies
(c) In the case of every individual, Hindu undivided family, unregistered firm and other association of individuals not being a registered firm or company—	
(i) For every rupee of the next Rs. 50,000 of such excess	1 anna and 9 pies
(ii) For the next Rs. 50,000 of such excess ...	2 annas and 3 pies
(iii) ,, ,, ,, ,, ...	2 annas and 9 pies
(iv) ,, ,, ,, ,, ...	3 annas and 3 pies
(v) ,, ,, ,, ,, ...	3 annas and 9 pies
(vi) ,, ,, ,, ,, ...	4 annas and 3 pies
(vii) ,, ,, ,, ,, ...	4 annas and 9 pies
(viii) ,, ,, ,, ,, ...	5 annas and 3 pies
(ix) ,, ,, ,, ,, ...	5 annas and 9 pies
(x) For every rupee of the remainder ...	6 annas and 3 pies

The Supplementary Finance Act of 1931 (November) imposed surcharges on the existing rates of super-tax similar to those on the income-tax rates noticed above. These were reduced in 1935 and 1936 to the same extent as in the case of the income-tax.

Incomes of Rs. 6 lakhs and above now (1938) pay the ordinary income-tax at the highest rate of the ordinary income-tax at two annas and two pies in the rupee *plus* $\frac{1}{12}$th surcharge in the rupee and super-tax at six annas and three pies in the rupee *plus* a similar surcharge, so that they pay a total income-tax of just above 50 per cent exclusive of the surcharges levied.

The highest rate in 1917, when the super-tax was first introduced, was 3 annas in the rupee on incomes of Rs. $2\frac{1}{4}$ lakhs and above. In 1921 it was 4 annas in the rupee on all incomes of Rs. $3\frac{1}{2}$ lakhs and above. In 1922, it was raised to 6 annas in the rupee on incomes of Rs. $5\frac{1}{2}$ lakhs and over, to 6 annas and 1 pie in 1930, and to 6 annas and 9 pies in 1931 (March).

Before the amending Act of 1920 the incomes of companies and registered firms paid the same super-tax rates on their undivided profits as the other incomes. But by that Act a new super-tax at the flat rate of one anna in the rupee on the whole undivided income of the companies and firms in excess of Rs. 50,000 was levied. This change was effected as the old system gave an incentive to companies to distribute more in dividends than was warranted by their real financial position, and penalized those companies which endeavoured to strengthen their reserves. In the year 1922, the flat rate was raised to $1\frac{1}{2}$ annas in the rupee, whatever the total income in excess of Rs. 50,000. The present rate is 1 anna in the rupee.

§10. **Reform of income-tax.**—Sir Walter Layton, the Financial Assessor on the Simon Commission (1930), pointed out various defects in the present income-tax system in India and suggested certain reforms as follows:

(i) The 1930-1 limits of exemption were too high, particularly for Indian conditions, both in the case of income-tax and super-tax, and should be lowered. [This criticism was largely met by the lowering of the exemption limits under financial pressure to Rs. 1,000 and Rs. 30,000 respectively by the Supplementary Finance Act of 1931 (Nov.).][1] It has been suggested, however, that the limit for income-tax cannot well be placed below Rs. 1,000, for otherwise it would be difficult to resist the demand that allowances should be given for wives and children. The objection to granting such allowances is that they would apply to the vast majority of individual tax-payers in India, and would, therefore, be very costly. Again, in the absence of a highly developed system of registration of marriages and births, there would be much scope for fraud, any attempt to prevent which would lead to 'inquisitorial investigations' into the domestic affairs of the assessees and cause much work and intense friction. A flat allowance for a family irrespective of its size will be only a rough and ready method of getting over the difficulty. Although *prima facie* the exemption limit appears to be high in comparison with England owing to the system there

[1] As pointed out above, the exemption limit was once again raised to Rs. 2,000 in the case of the income-tax with effect from 1 April 1936.

of allowances for wives and children, the exemption limit for a married man is higher in that country.[1] Further, owing to the fact that Indian income-tax differs from the English tax in that it does not distinguish between earned and unearned incomes, although the assessable limit in the case of a single person is higher in India, in the case of earned incomes the percentage taken as tax of the lower incomes is considerably higher here than in England. In fact, even in the case of unearned incomes, so far as the lower incomes are concerned, say of Rs. 2,400, the comparison is to the disadvantage of the Indian assessee.

(ii) The progression of the rate of income-tax for intermediate incomes between Rs. 5,000 and Rs. 1,00,000 should be steepened. The income-tax gradation before 1931-2 stopped at Rs. 39,999. Sir Walter Layton proposed both to steepen the present gradation and also to carry it on up to a lakh. This suggestion was largely carried out by the changes effected during 1931-2.

(iii) The exemption of agricultural incomes from income-tax should be removed by stages at specified dates.[2] The argument that land revenue is the counterpart of income-tax in other countries, and that to impose income-tax as well would be a form of double taxation, is not convincing, because land revenue cannot be increased in proportion to increased productivity even where there is temporary settlement, much less where there is permanent settlement. Frequent and substantial adjustments of land revenue assessments present serious political difficulties besides hitting the small holding equally with the large. An income-tax on agricultural incomes is not open to these objections. The present elaborate machinery for the maintenance of land records and for the administration and collection of land revenue could be effectively utilized for estimating agricultural profits. One of the advantages of the tax would be that, as a result of taking into account income from all sources—agricultural as well as non-agricultural—the non-agricultural incomes of people owning land would be subjected to a higher rate of income-tax. Incidentally, the change would check the present tendency for savings accumulated in industry to be invested in land in order to escape taxation.

As the income from all sources would have to be considered for determining the rate of assessment, the machinery of collection

[1] See *Government of India's Despatch on the Simon Commission Report*, Appendix II.

[2] The Taxation Enquiry Committee point out that the inequality between the landholders of different classes is aggravated by the absence of an income-tax on agricultural incomes or a death duty, which serves in the more advanced countries to introduce an element of progression in the land tax.

and administration would have to be Central and the rate would have to be fixed by the Central Government. But the yield could appropriately be assigned to the Province where it was collected.[1]

Income from foreign investments is at present exempt from taxation unless it is brought back to India within three years. This provision should be mended as it is not only detrimental to the revenue but is an inducement to send Indian capital overseas and to hold the income abroad until it can be brought home free of tax.[2]

The Government of India took steps in October 1935 to conduct a comprehensive review of the Indian income-tax system and administration by a committee consisting of two British experts and one of the senior Income-Tax Commissioners. A Bill to amend the Indian Income-Tax Act on the lines recommended (1936) by the committee has recently (April 1938) been referred to a Select Committee of the Central Assembly. It substitutes the 'slab' system under which progressive rates are applied to successive slices of income for the present 'step' system under which the tax is charged at the same rate on the whole income. It prescribes compulsory returns of income and seeks to tax the aggregate income of husband and wife. It aims at preventing tax evasion by people and firms who logically ought to be taxed, but under the law as it stands, can manœuvre their incomes or parts of them outside the range of the tax collector's rake. A number of provisions affect the joint-stock companies. Although the Bill has not met with the full approval of the business community, it constitutes an appreciable improvement over the existing position and should as such be welcomed.

§11. **Salt.**—The salt revenue was inherited by the British Government from its predecessors along with a large number of transit dues: these were abolished in 1843, and the salt duty was at the same time consolidated and raised. Before 1882 the rate of the duty varied from province to province. In that year it was made uniform at Rs. 2 per maund, but was raised to Rs. 2-8 in 1888 in

[1] In their Despatch on the Simon Commission Report, the Government of India argue that in spite of the theoretical objections to the exemption of agricultural incomes, it has the sanction of long tradition and that dealings in land have always been conducted on the assumption that it would remain. They also point out that most of the local Governments are definitely opposed to the removal of the exemption and regard it as unlikely that this reform should be put into effect in the near future (see *Despatch*, par. 62).

[2] The new Income-Tax Amendment Bill (1938) seeks to prevent tax-dodging of this type.

the period of falling exchange. It continued at that level down to 1903, when easier finances permitted its being lowered to Rs. 2-4. It was further reduced to Re. 1-8 in 1905 and to Re. 1-0 in 1907, at which level it continued till 1916, when financial stringency led to an increase in the duty to Re. 1-4. In the budget of 1923, the Government's proposal to raise the duty to Rs. 2-8 was rejected by the Assembly but was carried through by certification by the Governor-General. In 1924, however, the Assembly exercised the option given to it by the Government in favour of reducing the salt tax to Re. 1-4 per maund as an alternative to reductions in the Provincial Contributions. The duty was raised to Re. 1-9 with effect from 30 September 1931 by the Supplementary Finance Act of 1931 which imposed a surcharge of 25 per cent on the existing rate.[1] An unsuccessful attempt was made to reduce the basic salt duty of Re. 1-4-0 to 12 annas (which would have meant a loss of Rs. 3½ crores) by the Congress party in the Assembly in the Budget Session of 1935. The same party sought without success the complete abolition of the salt duty during the Budget Session of March 1936.

We have already indicated the different sources of salt in India and their relative importance (see vol. I, ch. ii, §39). There are two principal methods of levying the duty on the salt produced in the country. (i) The Government either manufacture the salt or obtain a monopoly of the supply, requiring private manufacturers to sell it only to the Government. It is then sold by the Government on payment of the duty. (ii) Secondly, as in Madras, the Government levy an excise duty and allow the manufacturer to sell the salt to private traders or the consumers. Government factories are in some cases leased to private individuals who manufacture and dispose of salt under a license from the Government. The total amount of salt consumed in India has varied in recent years between 5,15 and 5,37 lakhs of maunds. The yield from the salt tax was between Rs. 6 and 7 crores, which worked out at about 3½ annas per head per annum, before the imposition of a surcharge of 25 per cent on the customs and excise duties on salt under the Supplementary Finance Act of 1931. The revenue from salt, estimated for 1937-8, was Rs. 8·25 crores.

§12. **Criticism of the salt tax.**—The salt duty, although it is ancient, is one of the most unpopular taxes in India. It has been justified on the ground that it affords the only means in a country like India of reaching the masses by direct taxation. It is an accepted maxim of statecraft that every citizen should contribute something, however little, to the expenditure of the State. This

[1] See vol. I, ch. ii, §39, for the additional (Protective) Import Duty on salt.

will help him to develop a sense of responsibility and prevent him from supporting wholesale and costly changes in a reckless fashion. To this, however, a reply may be made that there is already a direct tax, namely land revenue, which is paid by the large majority in India. In the case of those who do not pay land revenue, it is generally a safe inference that they are so indigent that the idea of taxing them should be given up in spite of any political principle to the contrary. The principal objection to the salt tax is that it is a tax on a necessary of life, and a restriction in its consumption has an undesirable effect on the physique of the people. The fact that successive reductions in the salt tax from 1903 onward were followed by a considerable increase of consumption suggests that it had been kept at an unwisely high level before. It is a regressive tax since it presses more heavily on the poor than on the rich; for a comparatively larger proportion of their income is spent by the poor on salt than by the rich. The salt tax is often defended on the ground that it is an old tax, and that an old tax is no tax in the sense that from sheer habit people cease to think of it as a hardship. Essentially, however, the tax is undesirable and, though for practical reasons it may be impossible to abolish it immediately, this should be definitely recognized as the goal of public policy, and steady approaches should be made towards it. So long as the tax cannot be dispensed with, it should at least be maintained at as low a pitch as possible.[1] The existing machinery for collection makes it possible to secure additional revenue from this source with comparative ease, but an increase should not be thought of except in case of grave emergency, and should last only during such emergency.

§13. **Opium.**—As already hinted above, opium was until recently a very considerable source of revenue, and the occasional windfalls from this head were at one time notorious. With regard to the administrative aspect of opium revenue, the method of production and sale under Government monopoly was adopted in preference to heavy export duties, as being more satisfactory from the revenue point of view and as obviating the possibility of smuggling.

The revenue from opium until the end of 1935 was derived from three main sources: (i) the monopoly profits of the sale of opium manufactured in Government factories and intended for export to foreign countries; (ii) income from the export duty levied on the purchase of opium sent out from the Indian States of Rajputana

[1] Dr R. P. Paranjpye suggested 8 annas per maund as the normal rate of the tax. See *Taxation Enquiry Committee Report*, par. 168.

and Central India; and (iii) profits of monopoly in the form of license fees or vendor's fees derived from the internal consumption of opium in British India. This revenue was credited to or shown under the revenue from excise, and that from the first two sources under opium proper.

In 1907, under pressure from Whitehall, the Government of India entered into an agreement with China, and undertook to stop the export of Indian opium to China in ten years by a progressive reduction every year. China was to restrict her own production of opium and curtail her imports from elsewhere. The period of ten years was shortened by a further agreement in 1911, and since 1914 there have been no sales on Government account for export to China. The curtailment of exports to China was effected at the dictation of the Secretary of State, who in his turn was influenced by strong agitation in England in favour of the suppression of opium traffic with China. It was said that in this manner British righteousness was satisfied at the cost of Indian revenues. It was also complained that China herself had failed to fulfil her part of the agreement and had been unable to decrease her own production of opium. All the same India perhaps ought to be satisfied that she has done her duty by China and should cease to regret the loss of revenue. The loss from the curtailment of the export to China was not felt immediately on account of the rise in price of the opium sold. But at present (1938-9), the revenue from opium is very much lower than formerly, being less than half a crore of rupees as contrasted with the annual average of about Rs. 8 crores during the three years preceding 1913. It was announced by Lord Reading in February 1926 that the Government intended to abolish all exports of opium in future except for strictly medicinal purposes. With effect from April 1926, opium came to be exported under the system of direct sales to foreign and colonial Governments, the old system of auction sales in Calcutta having been discontinued. An import certificate was required in each case from the Government of the country of import, as prescribed by the League of Nations, before exports were permitted. The Government of India agreed to stop all exports of opium before the end of 1935. Accordingly, as Sir James Grigg, Finance Member, pointed out in his Budget speech (1936-7), the revenue from exports of provision opium has ceased since the end of the calendar year 1935. Now the receipts from opium are confined to opium sold for consumption in India; which is strictly regulated. Internal consumption is, however, still high according to the standard laid down by the League of Nations. Altogether opium as a source of income has faded into insignificance.

Provincial Heads of Revenue

§14. **Land revenue.**—We have already dealt with land revenue in chapter xii of vol. I. The total amount of land revenue collected in British India amounted to Rs. 31·89 crores in 1936-7, as compared with Rs. 35·27 crores in 1927-8. The drop was caused by the depression in the rural areas.

§15. **Excise.**—The excise revenue in British India is derived from the manufacture and sale of intoxicating liquors, hemp, drugs, opium and so on. It is levied in the form of a duty on manufacture, and fees for sale licenses. The major portion of the revenue is derived from country liquors. The system followed in regard to country liquor excise is that of granting by contract the right of wholesale supply for a district and selling by auction the right of retail sale. Two large distilleries in Bombay have been recently placed entirely under Government management, thus partly suppressing the contract distillery system. In 1861-2 the excise revenue was Rs. 1,78,61,570 and expenditure Rs. 13,53,470. In 1929-30 the revenue reached the high figure of Rs. 20,41,23,285 and the expenditure Rs. 2,19,18,391. Whether this astounding increase of net revenue is to be looked upon as an index of growing drunkenness is a matter of controversy. The Government explain it as being mainly the result of higher rates of excise duties, and a stricter control, though it is also suggested that some of the increase is due to the expansion of population and the greater prosperity of certain classes. In recent years, the excise revenue has considerably fallen owing mainly to the economic depression. For example it yielded Rs. 15·37 crores in the year 1936-7.

Public opinion in this country is, however, seriously alarmed at what it regards as an unmistakable sign of increase of drunkenness. Since the inauguration of the Reforms of 1921 the Legislatures in the various provinces have been bestirring themselves to grapple with the evil before it becomes even more serious than at present. The Bombay Council, for example, passed a Resolution in July 1924 in favour of total prohibition of liquor in twenty years.

Although there is a general agreement that energetic and courageous action is necessary for suppressing the evil of drink, there is no such agreement as regards the means to be adopted for this purpose. Before the assumption of Provincial Governments by Congress Ministries the Government relied largely on the method of raising the price of liquor as high as possible, but not so high as to stimulate illicit production. Other steps taken to reduce the consumption of country spirit were rationing, reduction

in the number of shops, lowering the limits of possession, reducing the strength of the drinks supplied, curtailing the hours of sale, etc.' Non-official opinion is inclined towards the restriction of quantity and a strict regulation of the number of shops, together with the policy of local option and consultation of local opinion, in preference to high rates of excise duties. The Bombay Government adopted the policy of issuing fixed quantities annually on a progressively diminishing scale, so far as country liquor is concerned.

The advent of the Congress Ministries pledged to a policy of prohibition in July 1937 has imparted a new urgency to this problem. Most of them have now launched a programme of prohibition varying in intensity according to local conditions and the capacity of each to bear the financial and administrative strain. The Madras Ministry has given a bold lead by applying prohibition throughout a whole district (Salem). Bihar has done likewise. Bombay has introduced prohibition in the town of Ahmedabad (July 1938). Some provinces have chosen smaller areas, others are taking measures to restrict the sale of liquor by closure of shops, tightening up licensing control, and proclaiming 'dry' areas where there is to be no manufacture or sale of liquor—which can, however, be brought in from outside and consumed.

It has to be borne in mind that any impatient and drastic measures will be attended with the double difficulty of immediate and heavy loss of revenue and excessive expenditure for preventive establishment to put down smuggling and illicit distillation. These difficulties will clearly be most stupendous if complete prohibition at one stroke were to be attempted. Another danger to be guarded against is that vice suppressed violently in one direction is apt to break out in another direction, and often in a very much worse form. Thus it is complained that attempts to reduce the consumption of country spirit have in some cases been attended with an increased consumption of foreign liquor, and that people have even taken to methylated spirit in place of country liquor. The suppression of the evil, in order to be completely successful, must come as the result of a general realization on the part of the people that drunkenness is a crime, and this is a matter of education. It should be remembered at the same time, however, that a wisely directed excise policy, besides decreasing the opportunities for indulgence, will also exercise a definite educative influence. The argument that reform must come from within and not from without must not be pressed to the point of denying any utility to measures whose intention is to increase the difficulties of excessive indulgence in drink. Such measures are useful at least in the case of those

who are not yet definitely addicted to the habit and who will be saved if they are kept out of temptation's way.

The practical statesman will bear in mind all these dangers and difficulties that are likely to obstruct the path of reform, and his policy will aim at achieving a happy commingling of daring and circumspection. He must honestly endeavour to relegate purely revenue considerations to a subordinate position and, in so far as this is done, we must expect a steady reduction in the revenue from excise hereafter. In recent years the revenue has in fact been stationary or actually diminishing in most of the provinces.

§16. **Other sources of revenue.**—(i) *Stamps.*—Stamp revenue is derived from judicial and commercial stamps. The former represents fees on plaints and other documents in Civil and Criminal Courts. The latter represents duties on commercial transactions recorded in writing, such as conveyances as to the transfer of property, lands, bills of exchange and so forth. The revenue from judicial stamps is held by some to be not taxation proper, being a payment for the services rendered by a costly department, namely the Judicial Department. The revenue from stamps in 1936-7 amounted to Rs. 11·88 crores in British India.

(ii) *Forests.*—The revenue under this head is derived mainly from the sale of timber and other produce, grazing fees and license fees for permission to cut wood and other produce. The revenue is variable according to market conditions. Its future prospects are bright if the forests are properly nursed and exploited. The gross revenue from forests (Central and Provincial) in 1928-9 was Rs. 5·79 crores, and the charges Rs. 3·34 crores, of which the Provincial shares were Rs. 5·53 crores and Rs. 3·01 crores respectively. The revenue for 1932-3 declined to Rs. 3·77 crores and the charges to Rs. 2·91 crores, the Provincial shares being Rs. 3·58 crores and Rs. 2·68 crores respectively. Thus, owing to the worldwide trade depression, the net profit from forests fell as low as Rs. 86·14 lakhs in 1932-3 and was only Rs. 74·90 lakhs in 1933-4. In 1934-5, however, the tide turned and the net profit rose to Rs. 1·34 crores.[1] The Provincial Governments, to whom forests have been assigned, were making a large net profit of about Rs. 2½ crores per year until recent years of trade depression. The net annual revenue was only about Rs. 14 lakhs between 1864 and 1870. Large initial expenditure, however, is necessary for ensuring a still more substantial and steadily growing revenue from forests. The gross revenue from forests amounted to Rs. 4·40 crores in 1936-7.

[1] *India in 1934-5*, p. 19.

(iii) *Registration, etc.*—The revenue from registration is akin to judicial stamps revenue and is mainly derived from registration fees according to the value of the documents registered. Registration is compulsory in the case of certain documents relating to gifts and transactions in immovable property, and optional in the case of others. Registration fees may be looked upon as payments for service rendered, the advantage lying in the consistency of deliberation, the publicity enforced on the parties and the provision of a record by way of satisfactory proof which may either prevent litigation or simplify its disposal by courts. The total revenue from this source is small (only Rs. 1·18 crores for British India in 1936-7).

(iv) *The Scheduled Taxes.*—These are taxes which the provinces have been empowered to impose at their discretion since the Reforms (1921). They have, however, not been much utilized, either because they are not very profitable or for other reasons. Betting and amusement taxes have been imposed in four provinces, namely Bengal, Bombay, Madras and Burma. Their yield is inconsiderable, being only Rs. 53·84 lakhs in 1936-7. It is naturally highest in the large capital cities.

§17. **Public expenditure in India.**—The following classification of public expenditure in India may be adopted.[1] (i) *National Defence :* Expenditure on army, navy, air force, frontier or strategic railways, harbours and defence works; military operations such as frontier expeditions, etc.

(ii) *Maintenance of internal peace and order.*—(*a*) Expenditure on police, courts of justice, jails; (*b*) general administration (*c*) expenses with regard to collection of revenue; (*d*) political charges including the expenses of the legislative machinery foreign representation by consuls, ambassadors, etc.; (*e*) pensions furlough allowances, etc.

(iii) *National Development.*—Expenditure for (*a*) moral and (*b*) for material development. Under the former may be included expenditure on education, including scientific and miscellaneous departments, medical and sanitation charges; under the latter may be included expenses on railways, irrigation and public works agriculture and famine charges, posts and telegraphs, interest on public debt. [The interest on unproductive or deadweight debt should strictly be included under (i) or (ii).]

§18. **Statistics of public expenditure.**—As an introduction to the discussion of public expenditure in India we give below some general statistics of expenditure, Central and Provincial.

[1] Shah, op. cit., pp. 44-6.

Table I below gives the principal heads of expenditure, Central and Provincial, charged against revenue in India and England in 1936-7.

TABLE I

EXPENDITURE (CENTRAL AND PROVINCIAL) CHARGED AGAINST REVENUE IN INDIA AND ENGLAND IN 1936-7

In thousands of rupees

Heads of Expenditure	Central	Provincial
Direct demands on revenue	4,27,12	8,69,08
Forest and other capital outlay charged to Revenue	83	11,02
Railway Revenue Account— (Interest on debt, subsidies, Reserve, etc.)	32,68,67	51
Irrigation, etc.—		
Revenue Account	9,64	7,08,70
Capital Account charged to Revenue ...	15	1,78
Posts and Telegraphs—		
Revenue Account	78,82	...
Capital Account charged to Revenue ...	3,58	...
Debt Services—		
Interest on Ordinary Debt	35,66,13	8,07,66
Deduct—Amount chargeable to Railways ...	29,61,83	50
,, ,, *Irrigation* ...	7,67	5,96,64
,, ,, *Posts and Telegraphs* ...	79,28	...
,, ,, *Forests* ...	69	13,58
,, ,, *Provincial Loans Fund*...	7,96,74	...
,, ,, *Provincial Governments.*	7	...
,, ,, *Salt Department* ...	4,09	...
,, ,, *Hydro-Electric Schemes* .	...	45,32
,, ,, *Other Government Commercial Undertakings*	2,80	1,09
Road Development Account	...	20
Remainder chargeable to Ordinary Debt ...	−2,87,04	1,50,33
Interest on other obligations	12,42,92	1,45
Reduction or Avoidance of Debt	3,00,00	1,46,66
Total Debt Services ...	12,55,88	2,98,44

Heads of Expenditure	Central	Provincial
Civil Administration—		
General Administration	1,80,49	10,77,21
Audit	1,09,14	...
Administration of Justice	8,00	5,22,23
Jails, etc.	22,88	2,25,03
Police	55,12	12,18,03
Ports and Pilotage, etc.	26,61	7,12
Lighthouses and Lightships	9,62	...
Ecclesiastical	29,78	...
Political	1,78,90	...
Frontier Watch and Ward	2,19,43	...
Scientific Departments	73,60	3,92
Education	30,32	12,18,86
Medical	26,31	3,70,77
Public Health	21,04	1,49,89
Agriculture	45,67	2,57,23
Industries	8,17	89,56
Aviation	21,78	4
Miscellaneous Departments	24,17	1,02,03
Indian Stores Department	22,25	...
Total ...	11,13,28	52,41,92
Civil Administration—		
Capital outlay on Industrial Development charged to Revenue	...	
Currency and Mint—		
Currency	18,62	...
Mint	19,09	...
Total ...	37,71	...
Civil Works—		
Civil Works	2,61,55	8,27,64
Bombay Development Scheme	...	3,68
Interest on capital on Hydro-Electric schemes.	...	59,43
Total ...	2,61,55	8,90,75
Capital outlay on civil works charged to Revenue	...	7,93
Miscellaneous—		
Famine Relief	6	15,35
Transfers to Famine Relief Fund ...	...	18,87
Pensions, etc.	2,82,71	5,08,41
Miscellaneous	1,31,06	1,42,99
Total ...	4,13,83	7,85,62
Commuted pensions	5,07	10,02
Military Services	50,67,25	...
Extraordinary	19,23	2,50
Grand total[1] ...	1,19,62,61	91,55,07[2]

[1] *Finance and Revenue Accounts of the Government of India* (1936-7), Tables Nos. 6 and 9.

[2] Includes Rs. 3,26,79,000 expenditure in England.

Table II shows the growth of public expenditure during the years 1858-9 to 1936-7.

TABLE II [1]

GROWTH OF PUBLIC EXPENDITURE IN INDIA (CENTRAL AND PROVINCIAL)

In crores of rupees

Year	Amount	Year	Amount
1858-9	50·19	1923-4	206·48
1870-1	49·39	1924-5 . . .	210·25
1880-1	52·64	1925-6	215·75
1890-1	51·98	1926-7	221·82
1898-9	58·29	1927-8	218·73
1899-1900	88·07	1928-9	222·21
1902-3	78·34	1929-30	226·81
1910-11	115·12	1930-1	230·42
1913-14	124·34	1931-2	220·09
1916-17	147·07	1932-3	209·55
1918-19	190·61	1933-4	205·27
1920-1	218·67	1935-6	209·76
1921-2	222·02	1936-7	211·18

§19. **Criticism of public expenditure in India.**—The figures given in Table II above show a striking growth in public expenditure in India since the beginning of the present century, and more especially since 1913-14 until the recent years of economic depression, which have made a reduction of expenditure to some extent inevitable. As the late Mr Gokhale pointed out long ago, an increase in public expenditure need not necessarily be a matter for regret and alarm. 'Everything depends in this matter on the nature of the purposes for which the increase has been incurred and the results produced by such outlay of public money. In the United Kingdom, in France, in Italy—in fact almost everywhere in Europe—there have been large increases in national expenditure . . . but the increase in Indian expenditure . . . differs from the increase elsewhere in a most fundamental respect. While increased expenditure in other countries, under popular control . . . has helped to bring increased strength and security to the nations, and increased enlightenment and prosperity to the people, our continually increasing expenditure has, under autocratic management, defective constitutional control and inherent defects of alien domination, only helped to bring about constantly increasing exploitation of our

[1] See K. T. Shah, *Sixty Years of Indian Finance* (second edition), p. 46; *Simon Commission Report*, vol. II, par. 254; *Statistical Abstract for British India* (1935-6), Table No. 108; and *Finance and Revenue Accounts of the Government of India* (1936-7).

resources, has retarded our national progress, weakened our natural defences and burdened us with undefined and indefinite financial liabilities. Compelled to meet the demands of a forward imperial frontier policy and the exigencies of conquest, imperial defence and constant borrowing for commercial enterprises, often undertaken in consequence of the pressure of English commercial classes, our Indian Government has little money to spare, with all its increase of taxation, for purposes of national education. . . .'[1] Mr Gokhale attributed a large part of the increase in public expenditure to the distrust and suspicion created by the Mutiny, which led to the wider employment of costly British services both in the civil and military branches. The most serious growth in public expenditure was caused during the War and post-War period. Our expenditure on military services was already high enough, namely Rs. 29·84 crores in 1913-14, but it rose by leaps and bounds to Rs. 43·56 crores in 1917-18, Rs. 66·72 crores in 1918-19, and Rs. 67·38 crores in 1920-1. Since then it has been reduced and stood at Rs. 54·92 crores in 1927-8. The military budget was stabilized in 1928-9 for four years at Rs. 55·1 crores (net).[2] The Inchcape Committee (1922-3) had recommended an immediate reduction of military expenditure from Rs. 67·38 to Rs. 57·75 crores, and urged that the Government of India should not remain satisfied with this but should keep a close watch on the details of military expenditure so as to bring it down after a few years to a sum not exceeding Rs. 50 crores if prices fell. The Simon Commission estimated that the army vote might drop to Rs. 52 crores when the present programme of army mechanization was ended and thereafter would fall still further so as to conform to the lower level of prices, provided there was no change in policy. Large reductions in Defence expenditure have been made in recent years[3] (though to some extent by emergency

[1] Written evidence of the late Mr G. K. Gokhale before the Welby Commission, 1897.

[2] The onset of the economic depression and financial stringency made it necessary to reduce the contract grant and to postpone the re-equipment programme.

[3] This substantial reduction in the military expenditure in recent years has been due to the fall in prices, revision of the pay to the British soldiers, contribution of Rs. 2 crores by the British Government towards Indian military expenditure in accordance with the findings of the Capitation Tribunal, postponement of equipment programme, retrenchment and army pay cut (Finance Member's Budget speech, 1934-5). Recently (1938) the British Government has agreed to contribute Rs. 80 lakhs towards the capital cost of mechanizing British cavalry and infantry units stationed in India. The British Government has also agreed to forgo the annual contribution of £100,000 made by India towards her naval defence provided she undertakes to maintain a sea-going

measures of a temporary character), the revised estimate for 1936-7 being Rs. 45·45 crores after allowing for military receipts. The military budget for 1937-8 was Rs. 44·62 crores after allowing for military receipts which were estimated at Rs. 5·22 crores. The revised estimates showed an increase of Rs. 2·60 crores owing mainly to the cost of the military operations in Waziristan. The total net provision for defence services for 1938-9 is Rs. 45·18 crores which represents an increase of Rs. 56 lakhs over the previous year's budget estimate. The methods of economy that have been suggested from time to time are reduction of the size of the army to the minimum required for strictly Indian purposes, and continuous and progressive Indianization so as to avoid expensive recruitment in England through the British War Office and heavy non-effective charges. The introduction of a short military service under the voluntary system has also been suggested instead of maintaining the army during times of peace practically on a war establishment.

Putting together Provincial and Central expenditure, the army accounted for 24·01 per cent of the total expenditure in 1936-7 (the percentage would be much higher if the Central expenditure only were to be taken into account). The argument from percentages is not in itself conclusive as regards the question whether military expenditure is heavier than it ought to be. Safety being a matter of paramount concern from the economic and every other point of view, almost every sacrifice must be undergone in order to secure it. The amount which a country must spend on defence will depend upon the character and intentions of possible enemies, the extent of vulnerability of the country's natural frontiers, etc. To show therefore that the burden is crushing or that it is comparatively higher than what some other countries have to bear, is not necessarily to condemn the actual scale of expenditure. While all this is perfectly true, we must beware of making a fetish even of military efficiency. We must also remember that a very poor country like India must, within certain limits, be prepared to take risks for the sufficient reason that she cannot afford to aim at an absolutely perfect state of readiness to meet all conceivable contingencies. Complete national safety may be secured on these lines, but the burden on the people will be intolerable.

fleet of not less than six modern escort vessels to be free to co-operate with the Royal Navy for the defence of India, and in addition to fulfil her responsibility for local defence of Indian ports.—(Finance Member's Budget Speech, 1938.) This arrangement is to be welcomed as it will assist the development of the Royal Indian Navy.

Popular Indian opinion holds that all practicable economies, even though fully compatible with safety, have not been carried out consistently and that military expenditure has been allowed to swell to unreasonable limits with the consequence that nation-building activities have been starved. In spite of the Government's protestations to the contrary, the belief is widely held that there is still considerable room for economy in military expenditure. It is remembered that the Government have always protested that the utmost economy is being practised. And yet the Inchcape Committee, in spite of the fact that its terms of reference did not allow it to consider certain fundamental aspects of army retrenchment, was able to recommend a substantial reduction and the Government did not find it impossible to carry out the economies and in recent years even to reduce the military budget much below the figure suggested by the Committee. People naturally, though perhaps illogically, argue that the economies already effected prove that still more economies are practicable. So long as the military administration remains outside the control of the chosen representatives of the people and so long as no Indians are admitted within the inner councils of the army, so long is this attitude bound to persist and military expenditure continue to figure as one of the major popular grievances against the Government.

The enormous increase in the expenditure on civil administration has been another never-ending subject of criticism, the general complaint being that the Indian administration is one of the costliest in the world and that the scale of salaries and allowances given to the higher services, until recently manned largely by Europeans, is excessive. The Reforms have further added to the costliness of the administration in a variety of ways. The increases in salaries, allowances and other concessions granted by the Lee Commission (1924) and estimated to add to the national expenditure to the extent of Rs. 1¼ crores annually, have been criticized as wholly unjustifiable on the ground that the original scales of pay were so high that no revision was called for in spite of the rise in prices. The present fall in prices lends further point to this criticism. The real remedy is rapid Indianization with a reduction in the scale of salaries. The economies effected in this manner will not be attended with any fall in efficiency provided the principle of communal preferences is either abandoned or applied as sparingly as circumstances permit. If preferences have to be given to certain communities in public employment, certain minimum qualifications should be insisted upon, and, as far as possible, selections even within a given community should be governed by competitive tests.

It is thus of the greatest importance that there should be a rigorous pursuit of economy in all the branches of administration, and those in charge of public funds should realize, in a fuller measure than is usual, the fiduciary position which they occupy with regard to the taxpayer and display a more exact diligence in the manner in which these funds are administered. We welcome the non-official resolution recently (April 1938) carried in the Central Assembly in favour of a retrenchment committee to review Central expenditure. We must however add that it is equally necessary that the folly of unlimited and indiscriminate parsimony should be recognized and expenditure should be as liberal as possible on departments like education,[1] agriculture, industries, irrigation, and public health. For unless money is freely spent on them the economic uplift of the people cannot be achieved.

§20. **Burden of taxation.**—The Statistical Abstract for British India (1935-6) gives the following figures bearing on the burden of taxation per head in British India:

In lakhs of rupees

—	1922-3	1927-8	1933-4	1935-6
Total taxation, Central and Provincial (including land revenue[2]) ...	1,32,79	1,40,18	1,30,79	1,39,37
Payment per head based on Census population in 1931[3] and assuming that the whole taxation is paid by the inhabitants of British India ...	Rs. as. p. 5 4 5	Rs. as. p. 5 5 0	Rs. as. p. 4 10 10	Rs. as. p. 4 14 3

. Sir Purshotamdas Thakurdas, in his speech as a member of the commercial deputation on retrenchment, gave the following estimates of the incidence of taxation.

1871	Rs. 1-13-9	1911	Rs. 2-11-3
1881	,, 2- 2-3	1913	,, 2-14-5
1901	,, 2- 6-6	1922	,, 6- 1-8

According to these figures the nominal incidence of taxation in 1922 was more than double what it was in the pre-War period.

[1] In Great Britain, the expenditure per head on education is £2 15*s*. In British India it is less than ninepence. *Simon Commission Report*, vol. II, par. 238.

[2] We have already referred to the view of the Taxation Enquiry Committee that land revenue ought to be regarded as part of the burden of taxation. *Ante*, vol. I, ch. xii, §28.

[3] Population figures for the intercensal period have been worked out on the assumption of a constant geometric rate of increase.

But whether this represents a real higher burden depends on the figures we adopt for the *per capita* incomes for the two periods.[1]

It is sometimes argued that because the *per capita* incidence of taxation in India bears a lower ratio (8 per cent) to the income per head (Rs. 80), therefore the Indian burden of taxation is light as compared to countries like Great Britain where the proportion of national income absorbed by taxation amounts to more than 20 per cent. This is however a superficial view, because the lower proportion of a low national income may represent a very much heavier burden than a higher percentage of a high income. Another obvious point is that the relative pressure of taxation in different countries cannot be considered apart from the nature of the services rendered by the state to the people in return for the taxes it levies.

§21. **Distribution of the burden of taxation.**—The problem of the incidence of taxation is one of the most complicated in economic science and is rendered more so in India owing to lack of precise statistical information regarding the income *per capita* and the distribution of the national income. In these circumstances the Taxation Enquiry Committee are thrown back on such general considerations about incomes and standards of living of typical classes of the population as a prudent Finance Minister would examine in framing or revising a scheme of taxation. They select a few typical classes of the population and offer certain tentative conclusions regarding their position as it then (1924-5) existed and as it would be in the event of certain changes in the taxation system being introduced. The Committee find that the burden on none of the classes is oppressive, though its distribution is unequal. Some of them escape their proper share of taxation, for example, the bigger landlords and the village trader, who might well be brought within the scope of further taxation by a more general and a more efficient administration of the circumstances, property and profession taxes.[2] Before the War, taxation was very unevenly distributed between the different classes of the community. The poorer sections of the community bore the brunt of the burden in connexion with the land revenue, salt tax, excise duties, stamps, etc., while the richer sections were able to resist their just share of taxation. The War and the post-War changes in taxation, while they have certainly increased the burden on the masses, have partially removed this blot on the taxation system of the country and made the incidence somewhat more equitable by the introduction of a graduated income-tax and super-tax, the levy of special import

[1] *Ante*, ch. iv, §5.

[2] See *Taxation Enquiry Committee Report*, pars. 478-92.

duties on luxury articles, etc. A considerable degree of inequality, however, still persists, as is illustrated by the following figures worked out by Professor K. T. Shah with reference to the year 1923-4.[1]

In crores of rupees

Head of Revenue	Amount of the tax burden borne by the rich strata	Amount of the tax burden borne by the poor strata
Customs	20	21
Land Revenue and Irrigation	20½	21½
Income-tax	20	...
Excise	...	20
Salt	1¼	7½
Forests and Registration	2	5
Stamps	6½	6½
Railways	33	60
Post Office	5	5½
Municipal Taxes	3	10
District Board Taxes	...	10
Total ...	111¼	167

From this table Professor Shah concludes that 'economically the weaker and less able section bears pecuniarily the largest proportion of the tax-burdens of India. Allowing for some *quid pro quo* in some of the above items (Railways, Post Office, etc.), we may yet say that while the richer class pays Rs. 100 crores in revenue, the poorer pays Rs. 150, that is, in terms of wealth deduction; while from the average family income of Rs. 1,000 per annum and over, the tax deduction aggregates Rs. 100 crores out of a total of Rs. 600 crores of wealth enjoyed by less than a twenty-fifth of the population, the remainder of Rs. 150 crores is deducted from a total wealth of about Rs. 1,000 or 1,200 crores enjoyed by the 96 per cent of the remaining population. This distribution can scarcely be considered to be either economical or equitable'.

The Taxation Enquiry Committee made various proposals to redress the inequalities,[2] such as higher rates of taxation for

[1] See Shah and Khambatta, *Wealth and Taxable Capacity*, pp. 289-91, and Shah, *Sixty Years of Indian Finance* (second edition), pp. 373-4.

[2] The Committee were appointed in 1924 to examine the manner in which the burden of taxation was distributed and to consider *inter alia* whether the whole scheme of taxation, Central, Provincial and Local, was scientific and equitable.

incomes from £1,000 to £10,000; reduction of the exemption limit for the super-tax to Rs. 30,000; a new rate of super-tax; reduction of the exemption limit in the case of a joint Hindu family to Rs. 60,000, etc.[1] They favoured the removal of the duties on kerosene and sugar as pressing disproportionately on the poorer sections of the community. As likely to be borne mostly by the richer classes, they suggested an excise duty on aerated waters, on cigarettes and pipe tobacco, licensing for country tobacco, increase in the license fees for firearms, etc.

It is gratifying that Sir James Grigg, the Finance Member, welcomes the proposal recently (March 1938) put forward in the Assembly for an inquiry by the Economic Adviser into incidence of taxation. 'I have no doubt', said Sir James, 'that taxation in this country lets off the rich too lightly and presses the poor too heavily, and it would be very valuable to have that verified scientifically, and particularly to see the cost laid by the present policy (of protection) upon the consumer not for the purpose of Government services but for the purpose of subsidizing industry.'[2]

§22. **Taxable capacity.**—In the words of Sir Josiah Stamp, taxable capacity or fund is measured by the difference between the two quantities—the total quantity of production and the total quantity of consumption'.[3] In the case of India the standard of consumption is very low, but, as we have seen, production also is very low, so that the difference between the two gives us a very small margin of taxable capacity. It is, however, impossible to estimate this margin with any degree of precision. In discussing the national income of India we have already commented on the paucity and unreliability of the available statistical data, and this makes it possible for people to pick and choose their evidence and present a bright or gloomy picture, as may suit them, of the economic condition of the masses. For obvious reasons the same remarks apply to calculations of taxable capacity. However, we give the following calculation[4] rather as illustrating the method of computation than as a thoroughly dependable estimate of taxable capacity on which actual practical policy might be based.

[1] These suggestions were largely carried out as a result of the Budget proposals for 1931-2.

[2] See also §45 below for Sir Otto Niemeyer's views on the incidence of the general scheme of Indian taxation.

[3] Stamp, *Wealth and Taxable Capacity*, p. 114.

[4] Taken from Findlay Shirras, *The Science of Public Finance*, p. 146.

TAXABLE CAPACITY OF BRITISH INDIA

In lakhs of rupees

Details	1910-11 (Census 1911)	1920-1 (Census 1921, a distinctly bad year)	1921-2 (Good for agriculture, but year of trade depression)
1. Income :			
Agricultural	1412,00	1715,00	1983,00
Non-agricultural	530,00	883,00	883,00
Total income	1942,00	2598,00	2866,00
2. Allow for minimum consumption...	1214,00	2220,00	2220,00
3. Allow for seed and manure ...	141,00	172,00	198,00
4. Allow for replacement of, and ordinary additions to, capital ...	25,00	45,00	55,00
5. Taxable capacity [1-(2+3+4)] ...	562,00	161,00	393,00
6. Tax revenue :			
Central and Provincial Governments	79,83	130,15	135,30
Local bodies	7,17	11,64	11,64
Total ...	87,00	141,79	146,94
7. Expenditure on internal debt :			
Central and Provincial Governments	5,61	21,04	24,27
Local bodies	1,70	2,34	2,34
Total ...	7,31	23,38	26,61
8. Effective taxation (6 — 7) ...	79,69	118,61	120,33
9. Balance (5 — 8)	482,31	42,39	272,64

The figures for taxable capacity and the balance of it still remaining untaxed which emerge from the above calculation must not lead the reader to suppose that it gives the practical limit to which taxation could be increased, if necessary. Sir Walter Layton, however, observes in this connexion that ' though the population of India consists in the main of extremely poor people, it is at the same time a country in which there are large accumulations of wealth on which the burden of government rests very lightly. . . . The public revenues of India can be substantially increased without taxation becoming intolerable, provided its incidence is adjusted to the capacity of the tax-payers to pay and that heavy additional burdens are not put upon primary necessities '.[1] The present,

[1] Dr P. J. Thomas in a recent (1936) lecture on ' India's Financial Position ' pointed out that while ' taxation in India was believed to be heavy, there were still sources on which tax-burdens fell lightly, and a reorganization of the tax basis might increase revenue and make the incidence more equitable. Even land revenue could be made to yield more by a reorganization of the basis of assessment and by a readjustment of the incidence as between the

however, is scarcely the time for imposing additional burdens light-heartedly as all classes have been badly hit by the depression.

§23. **Recent Indian finance.**—Owing to limitations of space it is impossible for us to enter into anything like a detailed history of Indian finance under the East India Company and the Crown. The confusion between the commercial and administrative accounts under the East India Company; the chronic deficits which characterized the administration of the Company; the financial burdens of the Mutiny; the appointment in course of time of a separate Finance Member; the gradual progress in financial decentralization; the embarrassments caused by famines, frontier wars and fall in exchange; the loan policy of the Government; the budget surpluses of the pre-War years, roughly since the beginning of the present century—these are some of the topics belonging to the history of Indian finance. We shall have something to say on one or two of these in greater detail, but for the present we propose to take note of the principal happenings in the domain of Indian finance since the outbreak of the War of 1914-18.

The smooth course of India's pre-War finance and the era of budget surpluses came to an end abruptly with the outbreak of the War.

The subjoined tables give the total Revenue and Expenditure (gross) of the Central Government before and after the Reforms.

TABLE I[1]

In crores of rupees

Year	Revenue	Expenditure	Surplus (+) Deficit (−)	Year	Revenue	Expenditure	Surplus (+) Deficit (−)
1914-15	76·15	78·83	−2·68	1918-19	1,30·40	1,33·13	−5·73
1915-16	80·01	81·79	−1·78	1919-20	1,37·14	1,60·79	−23·65
1916-17	98·53	87·31	+11·22	1920-1	1,35·64	1,61·64	−26·00
1917-18	1,18·70	1,06·57	+12·13				

different crops and tracts. When the spending of money was controlled from Whitehall, there were difficulties in raising certain taxes, but with the grant of provincial autonomy a bolder taxing policy would be practicable. Fresh sources of taxation like succession duties and terminal taxes had been set apart in the Government of India Act (1935) for the use primarily of the provinces, and to this might be added tobacco and agricultural incomes. When these sources were tapped, there would be ample funds for a forward economic policy in the Provinces'.

[1] These figures are exclusive of special items, such as transfers from and to the Revenue Reserve Fund and the appropriation of the balance at the credit of the German Liquidation Account.

TABLE II [1]

In crores of rupees

Year	Revenue excluding transfer from Revenue Reserve Fund (1)	Expenditure excluding transfer to Revenue Reserve Fund and provision for Reduction or Avoidance of Debt and items shown in (3) (2)	Transfer to Earthquake and other Funds (3)	Balance of (1) minus (2) minus (3) (4)	Transfer to or from Revenue Reserve Fund (5)	Provision for Reduction or Avoidance of Debt (6)	Final Surplus (+) Deficit (−) (7)
1921-2 ...	1,15·21	1,38·4	...	−23·19	...	4·46	−27·65
1922-3 ...	1,21·41	1,31·88	...	−10·47	...	4·55	−15·02
1923-4 ...	1,33·17	1,27·16	...	+ 6·01	...	3·62	+ 2·39
1924-5 ...	1,38·04	1,28·58	...	+ 9·46	...	3·78	+ 5·68
1925-6 ...	1,33·33	1,25·05	...	+ 8·28	...	4·97	+ 3·31
1926-7 ...	1,31·70	1,23·77	...	+ 7·93	−2·96	4·97	...
1927-8 ...	1,25·04	1,22·22	...	+ 2·82	2·22	5·04	...
1928-9 ...	1,28·24	1,23·88	...	+ 4·36	0·74	5·42	− 0·32
1929-30 ...	1,32·69	1,26·68	...	+ 6·01	...	5·74	+ 0·27
1930-1 ...	1,24·60	1,30·04	...	− 5·44	...	6·14	−11·58
1931-2 ...	1,21·64	1,26·50	...	− 4·86	...	6·89	−11·75
1932-3 ...	1,26·40	1,18·01	...	+ 8·39	...	6·84	+ 1·55
1933-4 ...	1,20·37	1,14·65	2·7[2]	+ 3·00	...	3·00	...
1934-5 ...	1,25·10	1,17·14	4·60[3]	+ 3·36	...	3·00	+ 0·36
1935-6 ...	1,22·01	1,16·72	0·45[4]	+ 4·84	− 1·84	3·00	...
1936-7 (Revised) ...	1,18·98	1,17·90	...	+ 1·08	...	3·00	− 1·92
1937-8[5] (Budget) ...	1,17·58	1,16·35	...	+ 1·23	1·84	3·00	+ 0·07

The dislocating effect of the War on trade and industry was immediately reflected in the conversion of the surplus of Rs. 1·8 crores to a deficit of Rs. 2·6 crores in 1914-15. The budget for 1915-16 also showed a deficit of Rs. 1·7 crores. As the War was expected to last only for a short period, the Government decided

[1] *Central Budget for 1937-8*, p. 75.

[2] Amount transferred to the Earthquake Fund; 0·63 out of this was utilized for debt redemption.

[3] 2·82 for Rural Development, 0·25 for Tribal Areas in N.-W.F., 0·20 for Broadcasting, 0·93 for Civil Aviation and 0·40 for special grant to Road Fund.

[4] Fund for capital outlay on buildings in Sind 0·17 and Orissa 0·27.

[5] The Budget estimates for 1937-8 include the changes due to the separation of Burma and the Niemeyer Award (see §40). The net cost of separation of Burma is Rs. 2·33 crores. Provincial Autonomy involves a total cost to the Centre of Rs. 1·85 crores.

to meet the deficit by temporary borrowing and by drawing on the balances in England, in order not to disturb the existing level of taxation. The programmes of capital expenditure on railways and irrigation were also considerably reduced. The expectation, however, that the War would be a short-lived one was doomed to disappointment. Important changes in taxation in the budgets of 1916-17 and 1917-18 became inevitable, and rigid economy was ordered in all the departments except the army department. The budget for 1916-17 provided for an increase in customs duties, income-tax, salt duty and excise duties. We have already dealt with the details of War taxation of this and the following years. In the budget for the year 1917-18 further increases in taxation became necessary in order to meet the cost of the War contribution of £100 millions to his Majesty's Government. The contribution was to be provided for by raising War loans in India and by taking over a part of the British War debt to the extent that the Indian loans fell short of the promised amount. The War contribution involved an annual burden of Rs. 9 crores for interest and sinking fund charges, and to meet this, increased taxation was resorted to in the form of the super-tax, rise in the cotton import duty to 7½ per cent, doubling the export duty on jute and levying a surcharge on railway goods traffic. The increase of taxation and excessive caution in framing the budget, together with retrenchment, resulted in a large surplus in the year 1916-17 (Rs. 11·2 crores) and 1917-18 (Rs. 12·12 crores). There was no necessity, therefore, to resort to further taxation in 1918-19, though the existing level of taxation was maintained. In 1918-19, however, owing to the promise by the Government of India of a further War contribution of £45 millions (a figure which was ultimately reduced), additional taxation became necessary and the excess-profits tax was levied for one year. During the period 1914-15 to 1918-19 the Central revenues showed a substantial increase from Rs. 76·1 crores to Rs. 130·04 crores and Central expenditure from Rs. 78·8 crores to Rs. 136·1 crores.[1]

§24. **Deficit budgets.**—In contrast with the budget surpluses which especially characterized the pre-War period, there now set in a succession of deficit budgets both in Central and Provincial finance. In five years the aggregate deficit in the budgets of the Central Government alone amounted to nearly Rs. 100 crores. On the top of the additional expenditure due to the European War, there was also the trouble caused by the wanton invasion of India

[1] We have already discussed the effects of War finance on the Indian currency and exchange position: see ch. vii.

by Afghanistan, which cost the Indian exchequer several crores of rupees. Again, the cost of civil and especially of military administration went on increasing year after year. The expenses of railway operations also showed a heavy increase, and the railway receipts suffered owing to the post-War trade depression which followed on the heels of a short-lived boom. Apart from diminished railway receipts there was the decreased yield from income-tax. The combined effect of all these factors was seen in the continuance of heavy deficits in spite of large increases in taxation between 1914 and 1922.

In 1922-3 the Retrenchment Committee was appointed to suggest means of reducing the overgrown expenditure of the Central Government. The Committee suggested several cuts aggregating Rs. 19¼ crores as follows:—Military expenditure, Rs. 10·5 crores; Railways, Rs. 4·5 crores; Civil Administration, Rs. 2·19 crores; Posts and Telegraphs, Rs. 1·3 crores.[1] In 1923-4, a reduction of Rs. 6·6 crores in the non-military expenditure and Rs. 5·75 crores in military expenditure was effected. But this did not suffice to restore budget equilibrium and, as we have seen, the Viceroy felt compelled to double the salt tax from Rs. 1-4 to Rs. 2-8. In 1923-4 the tide turned and there was a temporary reversion to the old tendency of surplus budgets due to excessive caution in revenue estimates, the stabilization of the rupee at 1*s*. 6*d*., the retention of the high level of taxation previously introduced and the gradual recovery of trade and industry. These surpluses were utilized to abolish Provincial contributions and reduce the unproductive debt. Since 1927-8, however, budget equilibrium was again disturbed and, as the Finance Member pointed out in his budget statement for 1930-1, excluding transfers from the Revenue Reserve Fund and eliminating exceptional items and windfalls such as the reparations share of India, etc., it could be seen that, since the final remission of the Provincial contributions there had been a succession of deficit years, and the gap caused in the revenue by the remission of contributions had not been fully filled even if an allowance was made for the depressed trade conditions. Thus in 1927-8, the deficit amounted to Rs. 2,21 lakhs, in 1928-9 to Rs. 1,06 lakhs, and in 1929-30 to Rs. 1,56 lakhs. The gap was closed either by transfers from the Revenue Reserve Fund (which was thus completely exhausted) as in 1927-8 and 1928-9, or by the German reparations payment as in 1929-30. This fact, coupled with a fall in the contribution from the railways to the General Revenues, essential new services and demands involving Rs. 1,46

[1] See *Report of the Retrenchment Committee*, part XI, par. 8.

lakhs (such as census operations, a grant for agricultural research, a special fund to finance measures for the management of sugar cultivation, a Banking Enquiry, better provision for the payment of bonus on cash certificates, broadcasting, the appointment of Indian Trade Commissioners, etc.) created a deficit of Rs. 5,52 lakhs on the basis of taxation in 1929-30. Even after effecting reduction in the aggregate of Rs. 1,42 lakhs (Rs. 62 lakhs, civil estimates; and Rs. 80 lakhs, military estimates), a net deficit of Rs. 4,40 lakhs had to be faced, and additional taxation (noticed above in §§5 and 9), amounting to Rs. 5,10 lakhs had to be imposed in 1930-1 thus leaving a surplus of Rs. 70 lakhs, which was provided for as a margin of safety.[1]

§25. **Indian finance in the years of depression and after.**—As the figures given below show, an acute financial crisis overtook the Central Budget (as indeed most of the Provincial Budgets) in 1930-3, owing mainly to the prolonged and severe economic depression and the heavy fall in prices. This led to very serious deterioration of many of the important revenue heads, such as Customs and taxes on income, and adversely affected the earnings of commercial departments like Railways and Posts and Telegraphs. The situation was for some time aggravated by special factors—internal disturbances and uncertainty caused by the prospect of fundamental constitutional changes.

We may now mention the outstanding features regarding Central finance in recent years. The revised estimates for 1930-1 revealed a net deficit of Rs. 13·56 crores as against a final budgeted surplus of Rs. 86 lakhs. The deficit on the basis of 1930-1 figures of revenue and expenditure was expected to be Rs. 17·24 crores, which the Finance Member proposed to reduce, by retrenchment in military expenditure of Rs. 1·75 crores and 0·98 crores in civil expenditure, to 14·51 crores in 1931-2. The deficit was to be covered by 14·82 crores of taxes, of which Customs duties were calculated to yield 9·82 crores and income-tax 5 crores, thus providing for 31 lakhs of surplus. These calculations were very largely upset during the next six months, and an emergency arose from the fact that the previous (March 1931) Bill would not yield sufficient income to meet the Government's needs. To meet the emergency Sir George Schuster introduced a Supplementary Finance Bill in the Assembly in September 1931. It was to remain in force for a period of 18 months (till March 1933). The deficit for 1931-2 was expected to be Rs. 19·55 crores and for 1932-3 Rs. 19·50 crores. Thus a total deficit of Rs. 39·05

[1] See Budget Statements for 1929-30 and for 1930-1.

crores had to be repaired during a period of 18 months. This gulf was to be bridged to the extent of ⅓ by retrenchment and an emergency cut (10 per cent) in salaries, and to the extent of ⅔ by more than Rs. 22 crores of new taxation. The changes in taxation affecting customs duties and income-tax have already been noticed. A surcharge of ¼ on all existing excise duties, including salt, and increased postal rates (one anna three pies for a letter and nine pies for a card) were other measures of additional taxation.

The immediate object of the Supplementary Budget was thus fulfilled and the gap in the budget was not only filled up, but, as the actual figures for 1932-3 revealed, there was a surplus of Rs. 1,55 lakhs after providing nearly Rs. 7 crores for reduction of debt. This result was secured partly by retrenchment, but mainly by additional heavy taxation aggregating Rs. 42 crores in three years (5 crores in 1930-1, 15 crores in the budget of 1931-2 and 22 crores in the Supplementary Budget—1931 October to 1933 March). The Budget for 1933-4 restored half of the pay cut and the Budget for 1935-6 provided for the full restoration of the cut. This was criticized on the ground that the claims of the taxpayer and of trade and industry to obtain relief from the high level of taxation ought to have been considered first. The year 1933-4 showed a surplus of Rs. 2,72 crores after the reduced provision of Rs. 3 crores for debt reduction had been made. This surplus was largely transferred to the Earthquake Fund to finance relief measures in respect of the damage caused by the earthquake in Bihar and Orissa in 1934. The only relief the taxpayer secured was a reduction in the rate of income-tax from 4 pies to 2 pies on incomes between Rs. 1,000 and 1,499. On the other hand, the Budget for 1934-5 introduced new taxation (sugar and match excise duties). The sugar excise was intended to meet a deficit of Rs. 1,53 lakhs in the revenue. The export duty on raw hides was, however, abolished and the silver duty was reduced to 5 as. per ounce. The actual figures for 1934-5 showed a material improvement over the original forecast, and a surplus of Rs. 4,95 lakhs was realized, owing mainly to the improved yield from customs duties on sugar, textiles and artificial silk. This non-recurring surplus was utilized for various objects including the grant of Rs. 2,81 lakhs to the Provincial Governments for constituting a Fund for the economic development and the improvement of rural areas; out of this Rs. 15 lakhs were allocated for the improvement of the Co-operative Movement. The Budget estimates for 1935-6, on the existing basis of taxation, showed a surplus of Rs. 1,50 lakhs which was available for tax reduction. The abolition of the export duty on raw skins reduced the surplus to Rs. 1,42 lakhs. In pursuance of their promise that

after the removal of the pay cut the first relief to be afforded to the taxpayer would be the removal of the surcharge on the income-tax and super-tax (the tax on small incomes being treated as a surcharge for this purpose), the Government provided for a reduction in the surcharge and the tax on small incomes by one-third at a total cost of Rs. 1,36 lakhs, thus leaving a nominal surplus of Rs. 6 lakhs. The actual figures showed a surplus of Rs. 2,29 lakhs. This improvement was due to the higher yield from the import duty on sugar, which had not fallen as much as it was expected to do, better receipts from the income-tax owing to trade recovery being greater than expected, and improvement under certain other revenue heads. This surplus was to be utilized for (i) building equipment in Sind (Rs. 17½ lakhs) and Orissa (Rs. 27½ lakhs) and for (ii) transferring to the Revenue Reserve Fund Rs. 1,84 lakhs for assisting the Central Budget in the first year of Provincial Autonomy.

The Budget for 1936-7 estimated a surplus of Rs. 2,05 lakhs, which was to be utilized (i) for giving the much-needed relief to the small income-tax payer by abolishing taxes on incomes below Rs. 2,000; (ii) for reduction by half of surcharges on income-tax and super-tax (see also §9); and (iii) for increasing the weight of a letter carried for one anna from half a tola to one tola; leaving on hand a small surplus balance of Rs. 6 lakhs. Owing, however, mainly to deterioration in revenue, especially under customs and partially income-tax, the revised figures for 1936-7 showed a deficit of Rs. 1,92 lakhs (the actual deficit was later found to be Rs. 1,79 lakhs). There was a startling decrease in the volume of sugar imports and a diminution in the general import trade. The deterioration under income-tax was due to decline in income-tax receipts from sugar manufacturing companies owing to the price-cutting following the establishment of an unnecessarily large number of sugar factories and partly to the fall in the profits of money-lenders caused by Provincial Rural Indebtedness Acts. To fill the gap in the revenue, sugar excise duties were raised as indicated in §7, and the duty on silver was increased to 3 as. per ounce by the Indian Finance Act of 1937. On the basis of this taxation a small surplus of Rs. 7 lakhs was estimated in the Budget for the year 1937-8. The revised estimates for 1937-8 showed a total improvement of Rs. 3,90 lakhs in revenue under customs and central excise duties following increased imports of durable (machinery and motor cars) and semi-durable goods, increased yield of income-tax owing to trade recovery, increased railway earnings, etc. On the other hand, there was an increase of Rs. 3,22 lakhs in expenditure, partly under Defence services mainly caused by the

cost of operations in Waziristan and partly under other items. Thus the net improvement was only Rs. 68 lakhs. The Budget estimates had provided for a nominal surplus of Rs. 7 lakhs after the utilization of the whole of the Revenue Reserve Fund of Rs. 1,84 lakhs. According to the revised estimates, as pointed out by the Finance Member in his 1938 Budget Speech, only Rs. 1,09 lakhs would be necessary to balance the budget, leaving Rs. 75 lakhs available for the year 1938-9.

The budget for the year 1938-9 provides for a small surplus of Rs. 9 lakhs. It contains no proposals for additional taxation, nor any relief from existing taxation, including the remaining surcharges on income-tax and super-tax which undoubtedly weigh heavily on trade and business. The Finance Member in his last (1938) Budget Speech claimed that it had been possible to provide the cost of the introduction of Provincial Autonomy, the separation of Burma and the expenditure on Waziristan expedition; to make a start on the distribution of income-tax to the Provinces to the amount of Rs. 1,38 lakhs in 1937-8 and 1,28 lakhs in 1938-9 under the Niemeyer Award (see §39); and at the same time to show balanced budgets both in 1937-8 and 1938-9 without the imposition of any new taxation. This was made possible by a steady improvement of trade conditions throughout 1937. This increased the revenues by Rs. 3·90 crores mainly from receipts from customs and railways as pointed out above. An increase in revenue together with the balance of savings specially kept for this purpose, were just sufficient to meet the extra expenditure incurred by the Central Government due to the inauguration of Provincial Autonomy and to provide for certain essential expenditure for the defence of India so that only a small surplus of Rs. 9 lakhs was left at the end of the two years.

While all this is true, we should like to emphasize the need for reducing the burden of special taxation imposed during the financial emergency of 1931-3.

§26. **Central (General) Budget.**—We give below a general statement of revenue and expenditure charged to revenue, of the Central Government for 1937-8 with actuals for 1921-2 for comparison. (See p. 559.)

§27. **The public debt in India.**—The origin of our public debt is to be traced to the wars of the East India Company which had steadily taken up the figure for national debt from £7 millions in 1792 to £59½ millions just before the Mutiny in 1856-7. In the following year the figure rose to £60⅓ millions. The whole charge of the Mutiny was thrown on India so that the total public debt amounted in 1860 to over £100 millions. When the Company's rule

Central Budget

In lakhs of rupees

	1921-2 (Actuals)	1937-8 (Budget estimates)		1921-2 (Actuals)	1937-8 (Budget estimates)
Revenue			**Expenditure**		
Principal Heads of revenue :—			Direct demands on the revenues ...	5,27	3,84
Customs ...		42,60	Salt Works and other capital outlay charged to revenue ...	...	0·5
Central Excise Duties ...	34,41	7,16			
Corporation Tax ...		1,45	Railways: Interest and miscellaneous charges (as per Railway Budget)	24,30	29,99
Taxes on Income other than Corporation Tax ...	18,74	12,85			
Salt	6,34	8,25	Irrigation ...	14	11·5
Opium	3,07	50	Posts and Telegraphs ...	1,66	80
Other Heads ...	2,21	94	Debt services ...	16,00	14,12
Total ...	64,77	73,75	Civil Administration	9,41	10,43
Railways[1] (net receipts as per Railway Budget)	15,21[1]	30,14	Currency, Mint and Exchange ...	1,07	34
Irrigation (net receipts) ...	6	1	Civil Works ...	1,54	2,87
Posts and Telegraphs ...	57	77	Miscellaneous ...	5,59	3,83
Interest Receipts ...	1,11	71	Defence Services ...	77,88	49,84
Civil Administration	77	92			
Currency and Mint	4,37	1,06			
Civil Works ...	11	35			
Miscellaneous ...	7,19	1,42	Extraordinary ...	...	
Military receipts ...	8,07	5,22			
Provincial contributions and adjustments ...	12,98	...			
Extraordinary items	...	5,07	Miscellaneous adjustments between the Central and Provincial Governments ...	...	3,16
Total revenue ...	1,15,21	1,19,42	Total expenditure ...	1,42,86	1,19,35
Deficit ...	27,65	...	Surplus ...	...	7
Grand Total ...	1,42,86	1,19,42	Grand Total ...	1,42,86	1,19,42

was abolished in 1858, the Government of India not only assumed responsibility for the territorial and other debts of the Company but also for the payment of the dividend on the capital stock of £12

[1] There was no separate Railway Budget till 1925-6. We have already dealt with Railway Finance in ch. v.

millions of the East India Company, until in 1874 the East India stock was redeemed. The debt inherited by the Government of India from the Company was purely unproductive. Since 1867, however, when the policy of constructing 'extraordinary public works' (or 'productive works' as they came to be called later on) like railways and irrigation, commenced, there has been a steady growth in the amount of productive or 'Public Works Debt' as distinguished from 'Ordinary Debt', as the unproductive debt came to be called from 1879. Additions to the former debt were made when the Government had to borrow for purchasing some of the railways from the companies or for making advances to them. In conformity with the recommendations made by the Select Committee of 1878 the surplus revenue of a particular year was not applied to the cancellation of debt but spent on productive works for which the Government would otherwise have been required to borrow. The reduction of the ordinary debt was thus automatically followed by an equivalent increase in the public works debt. By this process the ordinary debt would have been wiped off altogether by 1917 but for the huge addition to the debt for which the War was responsible. The late Mr Gokhale was a strong critic of the policy of utilizing the surplus revenue for reducing the ordinary debt and increasing the productive debt. He contended that in view of the smallness of the unproductive debt, there was no need to liquidate it out of Government's ordinary surpluses, which ought to have been returned to the taxpayer by remission of taxation or, better still, spent on beneficial non-recurring expenditure, such as education, medical relief, etc., to be met from special Provincial reserves to which the Imperial Government might have made grants from their surpluses.

By far the greater portion of the public debt of India during the pre-War period was raised in England. The Government defended this policy on the ground that the difference between the rates of interest in India and in England was so considerable as to counterbalance any disadvantages attendant upon borrowing in England. They had also a very poor idea of the resources of the Indian money market, whose maximum lending capacity in any single year they put at not more than Rs. 5 crores. It was left to the War and the post-War period to prove that this was very much of an under-estimate. During this period the ordinary debt increased rapidly from Rs. 3·1 crores on 31 March 1916 to Rs. 257·70 crores on 31 March 1924. This was due to India's War contribution of £100 millions,[1] the expense on New Delhi and the post-War era

[1] An additional War contribution of £45 millions was promised in 1918 in the event of the War being prolonged. But in 1919-20, in view of the

of successive deficits in the budget of the Central Government. Successive War loans were raised in India to meet some of these demands, as the English money market was fully taxed by the demands made on it by the English Government for war purposes, and the Government were able to get the unprecedented amount of Rs. 53 crores in 1917, and Rs. 57 crores in 1918. The strength of the Indian money market for Government loans, first revealed during the War period, has been largely maintained during the post-War years, and the Government now do most of their borrowing for productive purposes in the country itself. Apart from the large amounts raised by the War loans, another welcome feature of these loans was the increase in the number of investors, thanks to effective advertisement and offer of increased facilities in regard to the administration of the Public Debt at Government treasuries and sub-treasuries. In this connexion special mention must be made of the Post Office branch of the War loans and the Cash Certificates which have since secured a permanent place in the Government's loan policy.

Another innovation which owed its birth to the War was the introduction of Treasury Bills, first issued in 1917 for meeting the Government's disbursements on behalf of the British War Office. They were again resorted to for financing the deficits in the post-War period, when the old bills were paid by issuing new bills. Ultimately the large outstanding amounts of Treasury Bills were reduced by discharging these bills from the proceeds of long-term loans—a questionable procedure from the point of view of sound finance. Since the year 1929-30 the issue of Treasury Bills has again become a normal feature of Central finance.

§28. **Rupee and sterling loans.**—The loans raised in India are called rupee loans or rupee debt, as they are subscribed in rupees and the interest and principal are paid in rupees. It must not, however, be supposed that the rupee loans are necessarily internal loans or even held wholly by Indians. The bulk of the rupee debt is held in India, but a certain portion is held by investors who live in England and receive their interest in that country. Again, the rupee debt held in India is divided between Indian and European investors. It has been suggested that all debt, whether rupee or sterling, whether held in India or England, should be considered as external if held by non-Indians, and internal if held by Indians.[1]

heavy expenditure of £16 millions due to the Afghan War, the additional War contribution was substantially reduced.

[1] Gyan Chand, *Financial System of India*, p. 312.

Judged by this standard, the major portion of our debt is external.[1] It need scarcely be added that the policy should be to reduce the volume of the external debt as far as possible, because it creates all kinds of political difficulties and also complicates the Indian exchange problem.

§29. **The position of public debt in 1914 and 1936.**[2]—The following statement shows the interest-bearing obligations of the Government of India outstanding at the close of the financial years 1914 and 1936, and serves to illustrate the remarks made above regarding the growth of sterling and rupee debt, productive and unproductive debt and the changes during and since the War.

	31 March 1914	31 March 1936
INTEREST-BEARING OBLIGATIONS	*In crores of rupees*	
In India—		
Rupee Loans	145·69	425·91
Treasury Bills in the hands of the public	...	34·09
Treasury Bills in the Paper Currency Reserve	...	
Other obligations—		
Post Office Savings Banks	23·17	67·80
Cash Certificates	..	65·96
Provident Funds, etc.	10·93	95·99
Depreciation and Reserve Funds	...	12·74
Provincial Balances	...	4·93
Total Loans ...	145·69	460·00
Total other obligations ...	34·10	247·42
Total in India ...	179·79	707·42
	In millions of pounds	
In England—		
Sterling Loans	177·06	317·75
Unpaid balance of India's War contribution ...	...	16·72
Capital value of liabilities undergoing redemption by way of terminable Railway Annuities ...	70·60	41·75
India Bills	...	...
Provident Funds, etc.	...	1·27
Total in England ...	247·66	377·49
Equivalent at 1*s.* 4*d.* to the rupee in 1914 and at 1*s.* 6*d.* in 1931	371·50	503·32
Total interest-bearing obligations ...	551·29	1,201·74

[1] For an instructive treatment of the various items in the national debt of India (Rupee Loans, Sterling Loans, Terminable and non-Terminable Loans and Government Securities) see *Guide Book for Investors in Government of India Securities* (1921).

[2] See *Report of the Controller of Currency* (1934-5), and the Central Budget for 1936-7.

	31 March 1914	31 March 1936
	In crores of rupees	
INTEREST-YIELDING ASSETS—		
Capital advanced to Railways	438·64	757·38
Capital advanced to other Commercial Departments ...	14·08	24·30
Capital advanced to Provinces	71·99	186·82
Capital advanced to Indian States and other interest-bearing loans	(a)	20·92
Total interest-yielding assets ...	524·71	989·42
Cash, bullion and securities held on Treasury account ...	(a)	22·99
Balance of total interest-bearing obligations not covered by above assets	26·58	198·33

§30. **Debt redemption.**—In the pre-War period, the public debt of India was being reduced in two ways. One of these has been already noticed, namely the utilization of surpluses for capital expenditure on railways, irrigation, etc., which enabled the Government to avoid borrowing and to reduce the unproductive debt to that extent. The second method was adopted to meet the liability incurred in connexion with the purchase of certain railways. A portion of this liability was and is being reduced under the statutory obligation of payment of railway annuities (issued in repayment of both principal and interest on loans). So also the India Stock for which the shareholders of railways were permitted to exchange their annuities and the securities of the original companies from which the railways were purchased, is being reduced from certain sinking funds shown under railway account. During the War, a sinking fund was established in connexion with the issue of the 5 per cent War Loan of 1917. The Government undertook to set aside 1½ per cent of the loan for the purchase and cancellation of the loan securities, so long as their market price was below the issue price. In addition to this, the Government have been making annual provision to the extent of nearly £500,000 to meet India's liability in respect of the unpaid portion of the War contribution. The Government have also made provision for the optional payment of an extra Rs. 80 lakhs voted since 1921-2 for an additional depreciation fund for the 5 per cent loan.

But the position so reached was largely the result of accident and the whole question of the redemption of public debt had never

(a) Not available.

been reviewed in a scientific and systematic manner. A well-devised scheme for debt redemption is essential in order to maintain both the external and internal credit of the country unimpaired, so as to facilitate renewals of maturing debt and the raising of such new capital as may be required at reasonable rates of interest. A regular debt redemption scheme was accepted by the Assembly in December 1924 on the initiative of Sir Basil Blackett. In enunciating the principle of the scheme, Sir Basil Blackett suggested that the best way of arriving at a regular programme of debt redemption was to take the gross total of the debt, examine the capital assets held against it and fix the appropriate period within which it is desirable to amortize each category of debt. On this plan, the Finance Member announced a scheme on 9 December 1924, under which, for a period of five years in the first instance, the annual provision for the reduction or avoidance of debt to be charged against annual revenues was fixed at Rs. 4 crores a year plus 1/80th of the excess of the debt outstanding at the end of each year over that outstanding on 31 March 1923, sterling debt being converted into rupees at Rs. 15 per £ for this purpose.[1] As Sir Basil Blackett made it clear, the provision for the sinking fund so proposed would operate not to reduce the net total debt as long as there is a considerable annual programme of new capital expenditure, but to reduce the unproductive portion of it. The amount thus provided becomes a contribution out of revenue towards productive capital expenditure. The provision, therefore, is better described as a contribution out of revenues for the reduction or avoidance of debt than as a sinking fund.

With effect from 1930, adequate provision was also made for the first time to meet the accruing liability in respect of Cash Certificates, which were henceforward to be regarded as part of the Government's debt.

The Finance Member announced, in his Budget speech for 1930-1, that in view of the close interdependence of the Conventions regarding the Railways (providing for a certain fixed annual contribution to the general revenues, almost the whole of which is applied for the amortization of their capital) with the Convention as regards the debt redemption scheme, it was better to leave the latter provision untouched and to bring it under review at the time of the forthcoming general revision of finances. Accordingly it was decided that, for the time being, provision from the year 1930-1 onwards should be made on the same lines as before, except that sterling debt should be converted into rupees at Rs. 13⅓ per

[1] See *India's Parliament*, vol. X, p. 275.

£ instead of Rs. 15 per £.[1] Since 1933-4 (as Table II on p. 552 shows) the annual amount provided for the reduction or avoidance of debt has been reduced to a lump sum of Rs. 3 crores. This is justified on the ground that, since 60 per cent of the Government of India debt is attributable to the railways, it would be imposing too heavy a burden on the General Budget to revert to the Sinking Fund arrangements in force prior to 1933-4 before the railways had resumed the practice of making a contribution to the General Revenues. The Debt Redemption Scheme of 1924 has thus been temporarily suspended.[2]

FINANCIAL RELATIONS BETWEEN THE CENTRAL AND THE PROVINCIAL GOVERNMENTS

§31. **Financial relations before the Reforms of 1919.**—From 1833 to 1871, all financial powers were in the hands of the Government of India, which controlled the smallest details of the Provincial expenditure. The whole of the revenues were paid to the account of the Government of India, and the Provincial Governments only got fixed contributions to meet their expenses. This led to extravagance, rigidity and friction in Provincial finance and uncertainty in Central finance. 'The distribution of the public income degenerated into something like a scramble, in which the most violent had the advantage with very little attention to reason. As local economy brought no local advantage, the stimulus to avoid waste was reduced to a minimum, and as no local growth of the income led to local means of improvements, the interest in developing the public revenues was also brought down to the lowest level' (Sir John Strachey). This system of 'barren uniformity and pedantic centralization' was found to be thoroughly unsuited to a continental country with great diversity of local conditions. Lord Mayo[3] was impressed with the necessity of some measure of financial decentralization to enlist greater interest and more animated co-operation on the part of the Provincial Governments in developing the public revenues and managing them with all possible economy. He

[1] *Budget Statement for 1930-1*, pars. 25-6 and *Financial Secretary's Memorandum for 1931-2*, par. 32.

[2] Finance Member's Budget Speeches (1934-5, 1935-6).

[3] Dr Ambedkar divides the stages in the growth of financial decentralization, since Lord Mayo's reforms of 1871, according to the method of supply to the Provincial Governments adopted by the Government of India, namely, (*a*) Budget by Assignments (1871-2 to 1876-7); (*b*) Budget by Assigned Revenues (1877-8 to 1881-2); and (*c*) Budget by Shared Revenues (1882-3 to 1920-1). See B. R. Ambedkar, *Provincial Finance*, part II, chapters iv-vi.

initiated the system of 'Provincial Settlements' in 1871, under which certain heads of expenditure local in character were handed over to the Provinces, such as Police, Education, Roads and Civil Works, Registration, Medicine and Jails. For the management of these departments the Provinces were given, in addition to the departmental receipts, annual fixed lump-sum grants, the deficiency being made good by local taxation if necessary. This new arrangement led to greater harmony and more useful expenditure by the Provinces, which secured some freedom of appropriations within the limits of their resources.

No definite period was fixed for these new arrangements, which remained in force till 1877. Actual experience revealed various defects of this system. It failed to endow the Provinces with adequate revenues. The fixed Imperial grants for any year depended on the needs of the Central Government, and it has in fact been suggested that the real motive for this change was to afford relief to Imperial finance rather than to invest the Provinces with larger powers and responsibilities.[1] Again, the allocation of the grants was arbitrary owing to the ignorance of the Central Government with regard to Provincial conditions. The system did not provide any real motive for economy in the Provinces, as the Provinces were empowered to supplement their income by additional taxation which, under existing arrangements, could only mean an increased burden on the poor.

In 1877, a further step in decentralization was taken by Lord Lytton with the help of his Finance Member, Sir John Strachey. Practically all the remaining heads of expenditure that were Provincial in character, such as Land Revenue, Excise, Stamps, General Administration, Law and Justice, were transferred to the Provinces. In addition to the departmental receipts and the old lump-sum grants, certain heads of revenue such as Excise, Stamps, Law and Justice, were made over to the Provincial Governments. Under this arrangement, the heads of revenue were divided into Central and Provincial. The Government of India reserved to themselves a half share in the net increase in the yield of the Provincial heads of revenue, and undertook to bear a similar share of the deficiency if any in their estimated yield. It was found, however, that fixed lump-sum grants were still necessary from year to year and they caused the usual annual bickerings. The Provinces moreover showed no enthusiasm in the collection of revenue in which they were not given a share. Assam and Burma, being backward Provinces, were not admitted to the scheme described

[1] See P. N. Banerjea, *Provincial Finance in India*, p. 74.

above. Under a financial settlement effected in 1879, in addition to wholly Provincial revenues, Burma was given a share of the land revenue and also of the income from forests and the export duty on rice and salt, instead of a fixed assignment of money to meet the Provincial deficit. The same principle of shared or divided revenues was applied to the Province of Assam, which received a share of land revenue. This threefold division of revenues, namely (i) wholly Imperial, (ii) wholly Provincial, and (iii) jointly Imperial and Provincial, was later extended to other Provinces by Lord Ripon in 1882.[1]

In 1882 Lord Ripon, with the help of his Finance Member, Major Baring, introduced certain improvements in the Provincial settlements, which he made liable to revision every five years. He abolished the fixed lump-sum grants altogether and revised the allocation of the revenues as follows: (i) *Imperial heads*:—Opium, Salt, Customs, Commercial Undertakings, etc., (ii) *Provincial heads*:—Civil Departments, Provincial Works and Provincial Rates, (iii) *Divided heads*:—Excise, Assessed Taxes, Stamps, Forest, Registration, etc. Instead of giving fixed grants to the Provinces to make up their deficit, a certain percentage of land revenue was made over to them, together with fixed cash assignments under the same head, which thus became an important head of adjustment. Settlements on these lines were made in 1887, 1892, and 1897 without any change of principle, though not without much controversy and Provincial discontent. For the apportionment of revenue was unfair as between the Imperial Government and the Provinces and also as between one Province and another; and, while Provincial interest in the collection of divided heads of revenue was secured along with some elasticity in the Provincial resources, the chief defect of the revision of the Provincial settlements every five years was want of continuity of financial policy, the Provincial surpluses being appropriated by the Central Government for its own needs when the settlement expired. Moreover, if any Province economized, the reduced standard of its expenditure was taken as the basis of the next settlement. This killed all motive for Provincial economy and led to unedifying wrangling every five years.

To remove this defect and uncertainty Lord Curzon made the settlements quasi-permanent in 1904, that is, liable to revision only if there was a substantive change in the original conditions or in the event of emergencies like war and famine. The Provincial Governments also secured lump-sum grants—'doles' as they were

[1] See Ambedkar, op. cit., pp. 96-8.

called—from the windfalls of Central revenues or Central surpluses, for specific objects like police reform, education, sanitation, etc.

The settlements were declared to be practically permanent in 1912 by Lord Hardinge's Government, and the allocation decided upon was as follows: On the revenue side the Central Government retained for its use all the revenues which could not be allocated or traced to any Province, these being called the Imperial Heads of Revenue, such as Opium, Railways, Customs, Salt, Mint and Exchange, Posts and Telegraphs, military receipts, and tributes from Indian States. Of the remainder some were wholly Provincial, like Forest, Excise (in Bombay and Bengal), Registration, and the departmental receipts from such Provincial departments as Education, Law and Justice. Lastly, there was an important class of divided heads of revenue like Land Revenue, Income-Tax, Excise (except in Bombay and Bengal), Irrigation and Stamps. Receipts from these were divided between Imperial and Provincial Governments in stated proportions, generally equal, but determined separately for each Province. On the expenditure side a somewhat similar arrangement prevailed, and there was a special arrangement for the sharing of expenditure on famines. The pre-Reform system suffered from the following main defects: (i) The divided heads of revenue in which both the parties were interested were a source of constant interference on the part of the Central Government and hampered Provincial development. (ii) The occasional 'doles' given by the Central Government to the Provinces out of its surpluses had a dislocating influence on Provincial finance. (iii) Serious inter-Provincial financial inequalities were created. (iv) The Provincial Governments had no independent powers of taxation and borrowing. (v) Too detailed a control was exercised over the Provincial budgets and expenditure by the Central Government. The Provinces, for example, could not budget for a deficit nor could they spend their balances freely.

§32. **Financial relations since the Reforms of 1919.**—Since the Reforms the fiscal relations with the Central Government have been radically changed. As the new policy of responsible government was to be tried in the Provinces, and as Provincial financial autonomy or financial devolution was recognized to be the keynote of the Reforms, it was deemed necessary to abolish the divided heads of revenue, in order to give effect to the new principle, and the new allocation of revenue and expenditure was as follows: (i) *Imperial Heads of Revenue*:—Opium, Salt, Customs, Income-Tax, Railways, Posts and Telegraphs, Military receipts; (ii) *Provincial Heads of Revenue*:—Land Revenue (including Irrigation), Stamps (judicial and commercial), Registration, Excise and Forests. Mainly as a

result of the agitation carried on by the industrial Provinces of Bombay and Bengal against the complete loss of the revenue from income-tax, which was recommended to be an Imperial head of revenue by the Montagu-Chelmsford Report and Meston Committee (see next section), it was finally settled to give to the Provinces a small share of the income-tax revenue, equal to three pies in the tax collection on every additional rupee of the income assessed over and above the amount of income assessed in the datum year 1920-1. As the Taxation Enquiry Committee has pointed out, this rule has failed in its object and the whole system of dividing the income-tax on the basis of a datum line is unsound.[1]

§33. **The Meston Award.**—The abolition of divided heads of revenue and the provincialization of some heads like Land Revenue and Stamps resulted in a Central deficit of Rs. 9,83 lakhs, which had to be provided for by a scheme of Provincial contributions to the Central exchequer. A Committee was appointed in 1920 under the chairmanship of Lord Meston to consider this and other allied questions. The Committee's decision (the Meston Award, as it is called) with regard to the distribution of this burden by way of initial contributions in 1921-2 and the standard contributions payable, by regular gradations, in the seventh year beginning from 1921-2, together with the scheme of standard contributions as finally accepted, is summarized in the table on p. 570, which also shows the estimates made by the committee of the surpluses which would be left to the Provinces, as contrasted with the actual Provincial surpluses or deficits in the first complete year under the Reforms, 1921-2.[2]

Owing to the existing Provincial inequalities which they did not seek to remedy, the initial contributions were confessedly arbitrary and were based upon the increased spending power of the Provinces due to the new distribution of the revenue heads, and the only consideration that was borne in mind was so to fix the contribution of each Province that it should not be confronted with a deficit or compelled to resort to new taxation. Thus Madras was to pay Rs. 3,48 lakhs because the improvement in its spending power was Rs. 5,76 lakhs; Bombay, on the other hand, paid only Rs. 56 lakhs because the improvement in its spending power was Rs. 93 lakhs, and so on. The Joint Parliamentary Committee recommended that in no case should a Province be required to pay more than in the first year and that the standard contributions should be reached by gradual reduction in the aggregate Central

[1] *Taxation Enquiry Committee Report*, par. 529.

[2] See *Report of the Financial Relations (Meston) Committee*, pars. 17 and 28 and *Simon Commission Report*, vol. I, par. 399.

In lakhs of rupees

Province	Increased spending power under the new distribution of revenues	Standard contributions in 1921-2	Percentage contributions to deficit 1921-2	Percentage of standard contribution to deficit as recommended by the Meston Committee	Percentage of standard contribution to deficit as finally adopted	Meston Committee's estimates of increased spending power after payment of contributions in 1921-2	Actual surplus (+), or deficit (−) in 1921-2
Madras ...	5,76	3,48	35½	17	17-90ths	2,88	− 99
Bombay ...	93	56	5½	13	13-90ths	37	− 1,91
Bengal ...	1,04	63	6½	19	19-90ths	41	− 2,15
United Provinces ...	3,97	2,40	24½	18	18-90ths	1,57	− 1,48
Punjab ..	2,89	1,75	18	9	9-90ths	1,14	− 1,71
Burma ...	2,46	64	6½	6½	6½-90ths	1,82	+ 14
Bihar and Orissa[1] ...	51	*Nil*	*Nil*	10	*Nil*	51	− 15
Central Provinces ...	52	22	2	5	5-90ths	30	− 24
Assam ...	42	15	1½	2½	2½-90ths	27	− 24
Total ...	18,50	9,83	100 %	100 %	90 %	8,67	− 8,87

deficit, the relief being given to those Provinces whose initial contributions were in excess of their standard contributions and in proportion of such excess. These recommendations were embodied in the Devolution Rules issued under the Government of India Act, 1919. The standard contributions were supposed to be based on the capacity to pay of each Province as judged by such factors as population, income-tax receipts, consumption of salt and textiles, agricultural and industrial wealth, etc.

§34. **Abolition of Provincial contributions.**—The Meston Settlement did not please anybody and caused much Provincial discontent. For, while industrial Provinces like Bombay and Bengal could never reconcile themselves to the virtual loss of the income-tax revenue, agricultural Provinces like Madras, the Punjab and United Provinces resented what they considered their excessive initial contributions. The contributions were felt to be peculiarly burdensome when the Provincial Governments were faced with a series of heavy deficits in place of the comfortable surpluses which the Meston Committee had envisaged. The revenues assigned to them, such as land revenue, were inelastic and inadequate to meet occasional contingencies or even the expenses of normal development. There was thus an unceasing clamour for the abolition of the contributions.

[1] It will be seen that Bihar and Orissa escaped altogether.

The gradual improvement in the finances of the Central Government made the extension of some relief possible in 1925-6, when Rs. 2,50 lakhs, out of a total surplus of Rs. 3,24 lakhs, was utilized to grant permanent remissions of contributions to Madras (Rs. 1,26 lakhs), United Provinces (Rs. 56 lakhs), the Punjab (Rs. 61 lakhs), and Burma (Rs. 7 lakhs). In the next budget statement a further sum of Rs. 1,25 lakhs was remitted in favour of the same Provinces. In 1927-8, the entire amount of the outstanding contributions was remitted and finally relinquished in 1928-9.

§35. **Problem of federal finance in India.**—The final extinction of the Provincial contributions, however, did not end all controversy regarding the division of revenue between the Central and Provincial Governments. The main grievance of the Provinces, especially of the industrial Provinces like Bombay and Bengal, still remained, and this was that although its expenditure was comparatively stationary, consisting mainly of the cost of the army and the interest on the public debt, the Central Government had taken for itself sources of revenue like income-tax and customs, which were expanding or were capable of expansion, and left for the Provinces inelastic and stagnant sources like land revenue and excise, although the needs of the Provincial Governments were rapidly expanding. The land revenue was already too heavy in some places and is in any case fixed for long terms. Moreover there is a great disinclination on the part of the people to submit to additional increases. And such increases are becoming more and more difficult to make owing to legislative and administrative restrictions being imposed on the executive. The excise revenue must also decline, as steps were being taken in response to a strong popular demand to introduce prohibition.[1] In fact the Provinces complained that the process of decline was not as fast as they would have liked to see it. They hated the very touch of the tainted excise revenue, but were compelled, on pain of bankruptcy, to clasp it in what, until recently, threatened to be an eternal embrace. The forest revenue required liberal capital outlay before it could be appreciably expanded. Stamps offered the only source of revenue which held out a promise of probable increase. The Provinces were responsible for nation-building departments such as education, medical relief, agriculture, etc., on which heavy outlay was essential. Famine expenditure had also been put on the shoulders of the Provincial

[1] 'The doctrine of maximum revenue and minimum consumption is the theory generally accepted in the Provinces, but it is not always easy to hit off this point with precision, and excise revenue is likely to be reduced not merely by prohibition or propaganda, but by smuggling and evasion.'—*Simon Commission Report* (1930), vol. II, par. 255.

Governments. The Bombay Legislative Council pointed out in their representation to the Government of India in March 1925 that the distribution of surplus revenue assigned to the Provinces under the Reforms was determined in a haphazard manner and bore no relation to the needs of the Provinces or to the total taxation derived from them, and that this haphazard arrangement was founded upon the application of federal principles of finance which have not been adopted in any other federal Government in the world.

According to the same body the origin of the whole trouble was in the academic insistence by the framers of the Montagu-Chelmsford Report on the theory of complete federal separation. The authors of the Report urged that if self-government was to become a reality, the Provinces should be in a position to calculate their resources with certainty and to a certain extent be free to develop their own taxable capacity. The history of federal and provincial finance elsewhere, however, shows that an absolutely clean cut between Central and Provincial revenues is not possible.

The varying importance of the principal sources of revenue in the different Provinces, their unequal expansion in recent years, and lastly, the abolition of the contributions, which at first modified the effect of the new allocation of revenue, all served to emphasize Provincial inequalities. Compared with 1912-13, the Punjab budget of 1929-30 showed an increase of 154 per cent; that of Madras an increase of over 118 per cent; Burma, 110 per cent; United Provinces, Bengal, Bihar and Orissa, increases varying from 88 to 105 per cent. In Assam the increase was 88 per cent and only 68 per cent in the Central Provinces.[1]

The fundamental defect of the system, as pointed out by the Simon Commission Report, was that, while it professed to follow the theoretical ideal of federal finance, in practice it left inadequate resources to the Provincial Governments which, unlike the units of a federal state, did not possess full powers to determine the scale and nature of the expenditure of the Central Government. What was even more surprising was that the Government of India Act of 1919 left the residuary powers of taxation in the hands of the Central Government.

While the system gave a bare minimum to the more industrialized and commercial Provinces from which the Central Government collected large amounts of income-tax and customs, it yielded a substantial surplus to the agricultural Provinces which produced and retained for themselves a large amount of land revenue.

[1] *Simon Commission Report*, vol. II, par. 259.

The Provinces benefited in a very unequal manner from the new allocation of revenues, which was arrived at without any attempt to establish an objective standard of fairness. Such an objective standard was indeed difficult to adopt because equal efficiency of administration does not necessarily involve equal expenditure per head. It costs more to run a Province with a scattered population than one which is densely populated; a Province where salary- and wage-rates are high, than where they are low; a Province with a substantial urban population than one which is mainly rural. These considerations, however, did not fully explain the actual disparity as regards expenditure per head in the various Provinces, ranging from Re. 1·8 in Bihar and Orissa and Rs. 2·5 in Bengal to Rs. 8·3 in Bombay and Rs. 8·6 in Burma. These figures show that the standard of service rendered by Provincial Governments is very much lower in some Provinces than in others. Thus, while between 1922-3 and 1929-30 the three agricultural Provinces, Madras, Punjab and the United Provinces, showed an increase in the expenditure on transferred services (nation-building services) of 86 per cent, 82 per cent and 30 per cent respectively, the increase in the industrial Provinces of Bombay and Bengal during the same period was only 25 per cent and 14 per cent respectively. This disparity in expenditure has become even more noticeable since 1925-6.

Indeed as a result of the division of resources in 1920, all the Provinces received increased spending power. The benefit, however, was very unequally felt, and the abolition of the contributions accentuated the disparity in Provincial resources. The position when the Simon Commission reported (1930), however, was that, while all Provinces were faced with stagnation of revenues, future requirements everywhere were almost unlimited. About Rs. 40 to 50 crores could well be spent 'without extravagance and to the great economic advantage of India' in the course of the next ten years, and the crux of the problem was thus 'to find further revenues of this order of magnitude and to devise a financial plan by which they can be made available to those governmental authorities which need them'.[1]

Besides arming the Provinces with adequate spending power, without which Provincial autonomy is a meaningless phrase, the Indian financial problem is largely one of harmonizing the distribution of functions with the allocation of the sources of revenue to the Provinces and the Centre respectively. The sources of revenue which, from the administrative point of view, fall naturally within the sphere of the Provincial Governments, should harmonize so

[1] *Simon Commission Report*, vol. II, pars. 260-1, and 263.

far as their yield and elasticity is concerned with the functions assigned to these Governments, while those which are naturally Central sources should accord with the functions of the Central Government. The arrangements under the Meston Award were most defective from this point of view.[1]

§36. **Recent inquiries into the problem of financial relations.**—The authors of the Montagu-Chelmsford Reforms were right in pointing out that if self-government was to be a reality in the Provinces, it was necessary to set up a genuinely federal system of finance under which there would be a definite division of resources between the Centre and the Provinces, and the Provinces would be in a position to calculate their resources with certainty and to count upon a steady expansion of their revenues. However, we have seen above how the actual plan adopted under the Reforms of 1919 failed miserably in achieving this object.

(i) *Sir Walter Layton, the Financial Assessor of the Simon Commission*, has dealt with the problem very fully in his Report to the Commission. His proposals were based on the assumption that a Central surplus of about Rs. 14½ crores would emerge at the end of ten years, permitting a substantial re-allocation of revenues to the great advantage of the Provinces. He proposed that half of the proceeds of the tax on personal incomes together with the proceeds of certain excise duties including salt (to be distributed on a population basis) should be transferred to the Provinces according to a definite schedule and time-table, completing the transfer in ten years.

In order to expand their resources the Provinces were to be given the right to impose new taxes, namely, income-tax on agricultural incomes, Provincial surcharge on income-tax, and terminal taxes.

In the interests of uniformity, the excise duties were to be imposed or varied by the Central Legislature, on the initiative, however, of an Inter-Provincial Council consisting of the Finance Ministers of the Provinces. A Provincial Fund was to be formed and fed by these excises.

As the Government of India pointed out in their dispatch of 1930 on the Simon Commission, the Layton Scheme was conceived in a spirit of excessive optimism and, as a matter of fact, its forecasts of revenue were woefully falsified by the ensuing depression.

(ii) *The Peel Sub-Committee* (the Federal Finance Sub-Committee) of the Round Table Conference (second session, 1931) was concerned

[1] *Simon Commission Report*, vol. II, par. 240.

only with laying down the general principles of the financial arrangements under the new constitution.

(iii) *The Percy Committee* (Federal Finance Committee) was able to report in 1932 in a vein of restrained optimism and to visualize the allocation of a substantial amount of income-tax receipts to the Provinces. It, however, recommended a return in a modified form to the old system of Provincial contributions in aid of the Central Government.

(iv) *The Joint Select Committee* (1933-4) turned down the idea of reviving the unpopular system of Provincial contributions. This Committee was called upon to face the problem of the two new deficit Provinces of Sind and Orissa. Another complication which engaged its attention was the unwillingness of the States to allow a federal income-tax to be imposed within their borders. The income-tax would thus benefit the States as members of the Federation although it was contributed entirely by the British Indian Provinces. To avoid this anomaly, if for no other reason, the Joint Select Committee was inclined to consider favourably the suggestion that the whole of the income-tax yield should be assigned to the Provinces. But the intractable fact to be faced here was that the Central Government could not possibly afford this sacrifice.

(v) *The White Paper* proposed that taxes on income from federal sources should be permanently assigned to the Centre, and a specified percentage—not less than 50 per cent and not more than 75 per cent—of the normal taxes on income (except corporation tax) should be assigned to the Provinces. But the Federal Government was to have the right of retaining an amount to be fixed for three years, and thereafter to be reduced successively to zero over a period of seven years; and also the right (to be exercised in emergency) of levying a surcharge on taxes on income and raising equivalent contributions from the States. The Joint Select Committee did not approve of this idea of a federal surcharge on the income-tax, though they endorsed most of the proposals of the White Paper (1933), e.g. the proposal that the Provinces should have exclusive power to impose taxes on agricultural incomes, that the Federal Government should have the power to allot to the Units a share of the yield of salt and excise duties, export duties, etc. The Joint Committee, however, preferred to leave the actual time-table of transfer of revenues from the Centre to the Provinces as well as the percentage of income-tax to be transferred to be determined by Orders-in-Council at as late a date as possible.

The influence of all these previous investigations and especially of the recommendations of the Joint Select Committee is writ large on the financial provisions of the Government of India Act of 1935.

§37. **Financial provisions in the new constitution.**—The Government of India Act, 1935, contains the following provisions on the subject of federal finance under the new constitution: '

'*Section 137.* Duties in respect of succession to property other than agricultural land, such stamp duties as are mentioned in the Federal Legislative List, terminal taxes on goods or passengers carried by railway, or air, and taxes on railway fares and freights, shall be levied and collected by the Federation, but the net proceeds in any financial year of any such duty or tax, except in so far as those proceeds represent proceeds attributable to Chief Commissioners' Provinces, shall not form part of the Revenues of the Federation, but shall be assigned to the Provinces and to the Federated States, if any, within which that duty or tax is leviable in that year, and shall be distributed among the Provinces and those States in accordance with such principles of distribution as may be formulated by Act of the Federal Legislature:

'Provided that the Federal Legislature may at any time increase any of the said duties or taxes by a surcharge for Federal purposes and the whole proceeds of any such surcharge shall form part of the revenues of the Federation.

'*Section 138.* (1) Taxes on income other than agricultural income shall be levied and collected by the Federation, but a prescribed percentage of the net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Chief Commissioners' Provinces or to taxes payable in respect of Federal emoluments, shall not form part of the revenues of the Federation, but shall be assigned to the Provinces and to the Federated States, if any, within which that tax is leviable in that year, and shall be distributed among the Provinces and those States in such manner as may be prescribed:

Provided that—

(*a*) the percentage originally prescribed under this sub-section shall not be increased by any subsequent Order-in-Council;

(*b*) the Federal Legislature may at any time increase the said taxes by a surcharge for Federal purposes and the whole proceeds of any such surcharge shall not form part of the revenues of the Federation;

'(2) Notwithstanding anything in the preceding sub-section, the Federation may retain out of the moneys assigned by that sub-section to Provinces and States—

'(*a*) in each year of a prescribed period such sum as may be prescribed; and

(*b*) in each year of a further prescribed period a sum less than that retained in the preceding year by an amount, being the same amount in each year, so calculated that the sum to be retained in the last year of the period will be equal to the amount of each such annual reduction:

'Provided that—

(i) neither of the periods originally prescribed shall be reduced by any subsequent Order-in-Council;

(ii) the Governor-General in his discretion may in any year of the second prescribed period direct that the sum to be retained by the Federation in that year shall be the sum retained in the preceding year, and that the second prescribed period shall be correspondingly extended, but he shall not give any such direction except after consultation with such representatives of Federal, Provincial and State interests as he may think desirable, nor shall he give any such direction unless he is satisfied that the maintenance of the financial stability of the Federal Government requires him so to do.

'(3) Where an Act of the Federal Legislature imposes a surcharge for Federal purposes under this section, the Act shall provide for the payment by each Federated State in which taxes on income are not leviable by the Federation of a contribution to the revenues of the Federation assessed on such basis as may be prescribed with a view to securing that the contribution shall be the equivalent, as near as may be, of the net proceeds which it is estimated would result from the surcharge if it were leviable in that State, and the State shall become liable to pay that contribution accordingly.

'(4) In this section—

"taxes on income" does not include a corporation tax; "prescribed" means prescribed by His Majesty-in-Council; and

"Federal emoluments" includes all emoluments and pensions payable out of the revenues of the Federation or of the Federal Railway Authority in respect of which income-tax is chargeable.

'*Section 139.* (1) Corporation tax shall not be levied by the Federation in any Federated State until ten years have elapsed from the establishment of the Federation.

'(2) Any Federal law providing for the levying of corporation tax shall contain provisions enabling the Ruler of any Federated

State in which the tax would otherwise be leviable to elect that the tax shall not be levied in the State, but that in lieu thereof there shall be paid by the State to the revenues of the Federation a contribution as near as may be equivalent to the net proceeds which it is estimated would result from the tax if it were levied in the State.

'(3) Where the Ruler of a State so elects as aforesaid, the officers of the Federation shall not call for any information or returns from any corporation in the State, but it shall be the duty of the Ruler thereof to cause to be supplied to the Auditor-General of India such information as the Auditor-General may reasonably require to enable the amount of any such contribution to be determined.

'If the Ruler of a State is dissatisfied with the determination as to the amount of the contribution payable by his State in any financial year, he may appeal to the Federal Court, and if he establishes to the satisfaction of that Court that the amount determined is excessive, the Court shall reduce the amount accordingly and no appeal shall lie from the decision of the Court on the appeal.

'*Section 140.* (1) Duties on salt, Federal duties of excise and export duties shall be levied and collected by the Federation, but, if an Act of the Federal Legislature so provides, there shall be paid out of the revenues of the Federation to the Provinces and to the Federated States, if any, to which the Act imposing the duty extends, sums equivalent to the whole or any part of the net proceeds of that duty, and those sums shall be distributed among the Provinces and those States in accordance with such principles of distribution as may be formulated by the Act.

'(2) Notwithstanding anything in the preceding sub-section, one-half, or such greater proportion as His Majesty-in-Council may determine, of the net proceeds in each year of any export duty on jute or jute products shall not form part of the revenues of the Federation, but shall be assigned to the Provinces or Federated States in which jute is grown in proportion to the respective amounts of jute grown therein.

Section 141. (1) No Bill or amendment which imposes or varies any tax or duty in which Provinces are interested or which varies the meaning of the expression "agricultural income" as defined for the purposes of the enactments relating to Indian income-tax, or which affects the principles on which under any of the foregoing provisions moneys are or may be distributable to Provinces or States, or which imposes any such federal surcharge as is mentioned in the foregoing provisions, shall be introduced or moved in either

Chamber of the Federal Legislature except with the previous sanction of the Governor-General in his discretion.

(2) The Governor-General shall not give his sanction to the introduction of any Bill or the moving of any amendment imposing in any year any such Federal surcharge as aforesaid unless he is satisfied that all practicable economies and all practicable measures for otherwise increasing the proceeds of Federal taxation or the portion thereof retainable by the Federation would not result in the balancing of Federal receipts and expenditure on revenue account in that year.

'(3) In this section the expression "tax or duty in which Provinces are interested" means—

'(*a*) a tax or duty the whole or part of the net proceeds whereof are assigned to any Province; or

'(*b*) a tax or duty by reference to the net proceeds whereof sums are for the time being payable out of the revenues of the Federation to any Provinces.

'*Section 142.* Such sums as may be prescribed by His Majesty-in-Council shall be charged on the revenues of the Federation in each year as grants in aid of the revenues of such Provinces as His Majesty may determine to be in need of assistance, and different sums may be prescribed for different Provinces:

'Provided that, except in the case of the North-West Frontier Province, no grant fixed under this section shall be increased by a subsequent Order, unless an address has been presented to the Governor-General by both Chambers of the Federal Legislature for submission to His Majesty praying that the increase may be made.

'*Section 143.* (1) Nothing in the foregoing provisions of this chapter affects any duties or taxes levied in any Federated State otherwise than by virtue of an Act of the Federal Legislature applying to the State.

'(2) Any taxes, duties, cesses or fees which, immediately before the operation of this Act, were being lawfully levied by any Provincial Government, municipality or other local authority or body for the purposes of the Province, municipality, district or other local area under a law in force on the first day of January, nineteen hundred and thirty-five, may, notwithstanding that those taxes, duties, cesses or fees are mentioned in the Federal Legislative List, continue to be levied and to be applied to the same purposes until provision to the contrary is made by the Federal Legislature.

'*Section 144.* (1) In the foregoing provisions of this chapter "net proceeds" means in relation to any tax or duty the proceeds thereof reduced by the cost of collection, and for the purposes of

those provisions the net proceeds of any tax or duty, or of any part of any tax or duty, in or attributable to any area shall be ascertained and certified by the Auditor-General of India, whose certificate shall be final.

'(2) Subject as aforesaid, and to any other express provision in this connexion, an Act of the Federal Legislature may, in any case where under this Act the proceeds of any duty or tax are, or may be, assigned to any Province or State, or a contribution is, or may be, made to the revenues of the Federation by any State, provide for the manner in which the proceeds of any duty or tax and the amount of any contribution are to be calculated, for the times in each year and the manner at and in which any payments are to be made, for the making of adjustments between one financial year and another, and for any other incidental or ancillary matters.'

It will be noticed that while duties and taxes may be levied and collected by one authority, the proceeds may be allocated wholly or in part to others. It may therefore be useful to arrange the financial subjects according to whether they are under the legislative control of the Federal Government or of the Units.[1]

The Federal Legislative list comprises the following subjects: Duties of customs, including export duties; duties of excise on tobacco and other goods manufactured or produced in India except (i) alcoholic liquors for human consumption; (ii) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs; (iii) medicinal and toilet preparations containing alcohol or any substance included in (ii); Corporation tax; salt; taxes on income other than agricultural income; taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies; duties in respect of succession to property other than agricultural land; the rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts; terminal taxes on goods and passengers carried by railway or air; taxes on railway fares and freights.

The Provincial Legislative list includes the following subjects: Land revenue, including the assessment and collection of revenue; duties of excise on the following goods manufactured or produced in the Province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (i) alcoholic liquors for human consumption; (ii) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs; (iii)

[1] See J. P. Eddy and F. H. Lawton, *India's New Constitution*, pp. 133-5.

medicinal and toilet preparations containing alcohol or any substance included in (ii); taxes on agricultural income; taxes on lands and buildings, hearths and windows; duties in respect of succession to agricultural land; taxes on mineral rights subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development; capitation taxes; taxes on professions, trades, callings and employments; taxes on animals and boats; taxes on the sale of goods and advertisements; cesses on the entry of goods into a local area; taxes on luxuries, including taxes on entertainments, amusements, betting and gambling; the rates of stamp duty in respect of documents other than those specified in the provisions of the Federal Legislative List with regard to rates of stamp duty; dues on passengers and goods carried on inland waterways; tolls; fees in respect of any of the matters in this list, but not including fees taken in any Court.[1]

§38. **Financial inquiry by Sir Otto Niemeyer.**—The Secretary of State appointed Sir Otto Niemeyer to conduct the financial inquiry contemplated under sections 138, 140 and 142 of the Government of India Act (see §37 above). Sir Otto arrived in India in the middle of January 1936 and, after about three months' study of the material submitted to his examination, presented his Report, which was published on 30 April 1936. The Report indicated that it was possible to introduce Provincial Autonomy by April 1937, and the Federation about a year later. Sir Otto Niemeyer states that the budgetary prospects of India, 'given prudent management of her finances, justify the view that adequate arrangements can be made step by step to meet the financial implications of the new constitution'. (See §41 below.)

§39. **Main recommendations of the Niemeyer Report.**—The central recommendation made by Sir Otto Niemeyer relates to the assignment of a fifty per cent share of the income-tax to the Provinces by the Centre. Sir Otto calculates the income-tax to yield Rs. 12 crores a year (exclusive of the tax collected in Burma, which is separated from British India under the new constitution). Half of this (Rs. 6 crores) is assignable to the Provinces, but will be retained by the Centre for the first five years, during which the Centre should consolidate its position. In the course of the next five years, by six equal steps beginning from the sixth year from the introduction of provincial autonomy, but subject to Section 138(2)

[1] The Finance Ministers' Conference held at Delhi in January 1938 devoted much of its time to discussion of the sphere of Central and Provincial taxation. It was generally agreed that there was overlapping and that the position under the Government of India Act was obscure and might involve challenges in the Federal Court.

of the Government of India Act (1935), this revenue is to be made available to the Provinces gradually, so that after ten years the Provinces will be in the enjoyment of their full share of the income-tax. The income-tax is not to be thus relinquished, however, so long as the portion of the distributable sum remaining with the Centre together with any contribution from Railways aggregates to less than Rs. 13 crores.

§40. **Assistance to Provinces.**—Sir Otto Niemeyer proposes immediate assistance from the beginning of provincial autonomy to certain provinces, partly in the form of cash subventions, partly in the form of cancellation of the net (i.e. after offsetting certain balances) debt incurred prior to 1 April 1936, and partly in the form of the distribution of a further 12½ per cent of the jute tax. In the cases of Bengal, Bihar, Assam, the North-West Frontier Province and Orissa, the entire net debt is cancelled, and in the case of the Central Provinces, all pre-1936 deficit debt plus approximately two crores of pre-1921 debt.

Annual cash subventions are as follows: United Provinces 25 lakhs for 5 years only; Assam 30 lakhs; Orissa 40 lakhs; North-West Frontier Province 100 lakhs subject to reconsideration after 5 years; Sind 105 lakhs to be reduced by stages after 10 years.

The total approximate annual relief in lakhs aimed at by Sir Otto Niemeyer is as follows: Bengal 75; Bihar 25; Central Provinces 15; Assam 45; North-West Frontier Province 110; Orissa 50; Sind 105; United Provinces 25. The extra recurrent cost to the centre is Rs. 1,92 lakhs.

Orissa is to get a further non-recurrent grant of Rs. 19 lakhs and Sind of Rs. 5 lakhs.

Provincial share of income-tax.—The percentage division of the distributable portion of the income-tax between the Provinces is as follows:

Madras 15; Bombay 20; Bengal 20; United Provinces 15; the Punjab 8; Bihar 10; Central Provinces 5; Assam 2; North-West Frontier Province 1; Orissa 2; and Sind 2.

Sir Otto Niemeyer states that substantial justice will be done by fixing the scale of distribution partly on residence and partly on population, paying to neither factor a rigidly pedantic deference, for which the actual data provide insufficient justification.

§41. **Principles of settlement.**—The following are salient extracts from the Report: 'Throughout the discussions leading up to the Government of India Act, it has been recognized that at the inauguration of provincial autonomy, each of the Provinces should be so equipped as to enjoy a reasonable prospect of maintaining financial equilibrium and, in particular, that the chronic state of

deficit into which some of them had fallen should be brought to an end. My first object has accordingly been to examine the present and prospective financial position of the Provinces and to determine the extent to which special assistance would be needed in order to achieve the above aim. Next, it is necessary to consider how far the Central Government is in a position to render such assistance without jeopardizing its own solvency. Finally, I have had to look further into the future and to suggest to what extent and when it may be possible for the Centre to place additional resources at the disposal of the Provinces out of the proceeds of the taxes on income.

'From the Provincial point of view, the desirability of attaining this final result is undeniable and the only question (though in itself a difficult question) is to determine an equitable basis of distribution. From the Central point of view, on the other hand, it is clear that the financial stability and credit of India as a whole must remain the paramount consideration. Moreover, this is as essential to the Provinces and to the success of Provincial autonomy as it is to the Centre itself. Throughout my recommendations, I have kept the stability of the Central finances continuously in mind. Expenditure at the Centre cannot be expected, consistently with safety, to decrease much below the point to which it has now been reduced. There may be future savings on debt conversions but so far as they remain with the general budget, they hardly seem likely to do more than assist in reinstating a more adequate contribution to debt redemption than the present reduced figure of 3 crores. It is, however, at least unnecessary to contemplate any serious increase in the total expenditure unless the railway budget, contrary to expectation, fails to improve.

'Expenditure in the Provinces could obviously be increased with advantage on many heads. This is a question of degree and opportunity. Some expansion in fact took place even with the existing Provincial resources, especially in the years before the slump when many Provinces were able, for instance, to increase substantially their expenditure on education. It may now be anticipated from the recovery of Provincial revenues, not all of which are or need be static. Nevertheless, the allocation at an early date of a share in taxes on income under Section 138 of the Government of India Act constitutes, for many Provinces, the main hope for the future expansion.

'On a general review of the existing tendencies, I should conclude that the budgetary prospects of India, given prudent management of her finances, justify the view that adequate arrangements can be made step by step to meet the financial implications of the

new constitution. A change of constitutional and administrative arrangements cannot of course in a moment alter the general financial position or enable all conceivable financial desires to be met, but I see no reason why a cautious but steady advance should not be achieved.

§42. **Claims of Provinces.**—(i) ' I turn now more particularly to the prior question. The present position of the Provinces and their contrasted positions *inter se,* both of which fall under the objective of starting the Provinces on the occasion of autonomy on " an even keel ". Various matters arise in this connexion. How far in actual fact is each Province now solvent and likely to remain solvent? This is a matter which cannot be judged on the position in one year only. How far, whatever may be its present position, has a Province administered its affairs, whether in taxation or in expenditure, with adequate firmness and how far has this or that Province, for whatever reason, been financially neglected in the past and thereby condemned to a lot from which others have escaped? It is obviously impossible to reconcile all the conflicting views and arguments on these issues. The recommendations I shall make represent, in my belief, an equitable settlement as between the various contestants and will, I hope, be accepted on that basis. I would only add here that in any country of the size of India there must inevitably be substantial differences in the standard of administrative needs and possibilities just as there are in other areas of the same size in the rest of the world or, for that matter, even in smaller units.

' It is obvious, as the Percy Committee said, that special assistance to *certain* Provinces which, whatever precise form it takes, can only be given at the cost of the Central revenues, operate to delay *pro tanto* the general transfer to *all* Provinces of their share of the taxes on income. This consideration cannot be absent from the mind of anyone endeavouring to deal fairly with the whole problem and sets one limit to the amount of prior readjustment which can reasonably be admitted. At the same time, it is equally clear that some Provinces are intrinsically better off than others and at the moment less urgently in need of additional resources; and it is both fair and inevitable that a certain measure of correction should be applied, even if it means that Provinces which have been able to attain higher standards of administration should now, to some slight extent, have to progress more slowly.

' Certain further general comments may be made. Bombay has just received an annual relief to the extent of approximately 90 lakhs from the separation of Sind; Madras and Bihar approximately 20 lakhs and 8 lakhs respectively from the separation of Orissa.

Madras, Bombay and the Punjab have certainly not the lowest administrative standards in India. Bengal is clearly on a low standard, while Bihar and Orissa has been generally recognized as the poorest Province in India. To a less extent, similar considerations apply to the Central Provinces. The position of the United Provinces is so far peculiar that while its ultimate future gives less reason for anxiety, its immediate difficulties are considerable.

(ii) *Sind.*—'Sind and Orissa, as newly instituted Provinces, have special problems of their own. The future of Sind and of the subvention as part of Sind finances is inseparably bound up with the financial future of the Lloyd Barrage. In all the circumstances and bearing in mind the necessarily conjectural nature of estimates for a period stretching so far into the future, I recommend that the Sind subvention should remain at 105 lakhs for a period of 10 years (i.e. till 1946-7 inclusive) and should then be diminished by 25 lakhs a year for 20 years, by 40 lakhs a year for the next 5 years, by 45 lakhs a year for the next succeeding 5 years, and thereafter until the whole Barrage debt is repaid, by 50 lakhs a year. When the debt has been repaid, i.e. in about 40 years from funding in 1942, any remaining portion of the subvention will, of course, in any event cease.

(iii) *Orissa.*—' It is impossible to ignore the fact that the existing standard of expenditure in Orissa is extremely low and the scope for expansion in the Province's own resources in the early future is unusually limited as against the provision of 40½ lakhs in 1936-7 for recurrent Orissa expenditure. It is therefore necessary to contemplate a somewhat higher normal scale of assistance. The total assistance which I propose should be given to Orissa is about 57 lakhs in the first year, 53 lakhs a year in the next four years and, thereafter, 50 lakhs a year.

(iv) *Assam.*—' Assam has been universally recognized as a deficit Province and must undoubtedly receive assistance. The measure of the assistance depends partly on the prospective revenue of Assam allowing for a very moderate amount of continued recovery and partly on the degree to which the existing Provincial deficit (47 lakhs in 1935-6) can be regarded as having been unavoidable (either as regards expenditure or taxation). Allowance has further to be made for the cost of provincial autonomy and for certain adjustments of expenditure with the Centre, including the cost of the Assam Rifles, hitherto mainly borne by the Central Government. At present the Central Government pays 12 lakhs per annum towards the total cost of the Assam Rifles (15 lakhs). In future the Central Government will in any case pay the cost of the Manipur Battalion (approximately 3 lakhs). The Central Government now proposes to

bear 7 lakhs of the cost of the remaining Assam force and to treat this payment separately from any assistance for Provincial needs proper. I think this is an equitable arrangement.

(v) *North-West Frontier Province.*—' The North-West Frontier Province, which has since 1932 received an annual subvention of 1 crore from the Central Government, is so far in a special position that Section 142 of the Government of India Act permits an increase in its subvention at any time without an address from the Federal Legislature. It is however desirable, both from the point of view of the Province and from that of the Central Government, that the subvention should be fixed for a certain period of years. After examining the past and prospective budgetary position of the Province, my recommendation is that the existing subsidy of 1 crore should be supplemented by approximately 10 lakhs per annum. In so far as this assistance may take the form of a subvention under Section 142, it should be fixed for a period of five years which should be subject to revision in the light of the then existing circumstances.

§43. **The Central Government's position.**—' Can the Centre support such an additional demand? Apart from this sum of nearly two crores per annum, concurrently with the inauguration of provincial autonomy, Burma will be separated from India at a net loss to the Central revenues now estimated by the Government of India at about 2¾ crores. These two items together clearly would present a budgetary problem of some magnitude if they had to be faced in 1937-8, at one blow and so soon, from the normal resources of a single financial year. Thereafter, owing to the expansion in the Central resources which may with confidence be anticipated, they need occasion no special difficulty. Thanks, however, to the Reserve Fund of about 2 crores which is being constituted out of the anticipated surplus of the year 1935-6, I see no reason why the grant of these additional resources to the Provinces should not commence in 1937-8.

' In so concluding, I should be lacking in frankness if I did not make it clear that the scope in the next few years for the relaxation of revenue burdens is likely to be extremely small unless economic improvement takes place at a rate well in excess of what can now safely be assumed. I have, however, felt it right to assume that the establishment of provincial autonomy must be regarded as an objective to which the Government of India will give special consideration in assessing the relative order of its financial aims.

' From the financial point of view, I conclude that His Majesty's Government may safely propose to Parliament that Part III of the

Government of India Act 1935 (Provincial Autonomy) should be brought into operation a year hence.

§44. **Claim of jute Provinces.**—' The claim of the jute-producing Provinces to the whole or part of the jute export duty has already been recognized to the extent of 50 per cent by the Government of India Act. In my opinion, it is doubtful whether the argument that the incidence of this particular duty falls wholly on the producer can be maintained. No concrete statistical proof of this contention has been produced and, even if such proof could be produced for a specific date, it may be doubted whether it would be valid in all the circumstances of a changing market. Further, even if the argument were completely substantial, it would not be conclusive on the question whether or not the community as a whole in India was entitled to tap this source of revenue as it must in fact tap other sources of revenue of unequal provenance among the different parts of India. No source of revenue, whether customs, excise or income-tax, can in fact in any country be derived equally from all parts of the country alike, rich and poor, agricultural or industrial. In so far as a claim may be put forward on the ground that the taxable capacity of Bengal is limited by the incidence of this duty, that is a claim not so much to this particular duty as to financial assistance generally. It is part in fact of the case for a share in taxes on income or for such prior special treatment as it is the object of my present recommendations to secure. It may be thought that whatever validity there may be in the economic argument has already been met by the surrender to the Provinces concerned of 50 per cent of the net produce of the duty. It will, however, be convenient that part of the assistance I contemplate should take the form of an increase in this figure and therefore I recommend that the percentage should be increased under Section 140 (2) of the Act to 62½ on the estimated gross yield of the duty in 1936-7 at 380 lakhs. This increase of 12½ per cent would mean in round figures the following additions to the resources of the Provinces concerned at a corresponding cost to the Central Government: Bengal 42 lakhs; Bihar 2½ lakhs; Assam 2¼ lakhs; and Orissa rather over ¼ lakh.

' Apart from the separation of Burma and this provision of 2 crores' assistance for the Provinces which I have already recommended, the additional cost of the new federal institutions (probably something over half a crore) may be imminent, and provision may have to be made for financial adjustments in respect of the States under Section 147 of the Act, at a net ultimate annual cost now estimated at rather more than half a crore, though the full annual charge on this latter account will presumably not fall to be met

in the early years. If, however, there is bound to be delay, the Provinces will no doubt recollect that they will be receiving from the Centre the amounts proposed above, in addition to what certain of them have already been receiving from the jute export duty and about Rs. 1½ crores per annum for roads as well as certain grants (Rs. 3½ crores) for rural purposes. Some of them have also received substantial assistance through being relieved of deficit areas.

§45. **Burden of income-tax.**—' I wish to add two comments on these recommendations. After the abolition of the tax on the smaller incomes and the two successive reductions in the rates imposed in 1931, the rates of income-tax and super-tax in India, especially on the higher incomes, are by no means excessive. The general scheme of Indian taxation (Central and Provincial) operates to relieve the wealthier commercial classes to an extent which is unusual in taxation schemes, and there would be no justifiable ground of complaint if a slight correction of this anomaly were maintained. The assignment of taxes on income is the main method of assisting Provincial finances contemplated by the Government of India Act, and if the remaining surcharge were maintained, it would materially contribute to the early receipt by the Provinces of additional resources.[1]

§46. **Basis of distribution of income-tax.**—' Naturally each Province advocates the basis of division (population, residence etc.), which gives it the largest dividend. It cannot be said that any of the proposed bases have any particular scientific validity, or satisfy, in any appreciable degree, the ideal but practically unascertainable test of capacity to pay.

' The mere accident of place of collection, as has frequently been pointed out in previous discussions of this subject, is clearly an unsuitable guide. The residence of the individual, though it may be a convenient and practical dividing line for purposes of avoiding double taxation between separate political units, is not in itself a very scientific criterion, particularly in a Federation, and, in fact in India, gives results (of necessity partly estimated) too suspiciously near those of collection to inspire much confidence.

' Finally, even supposing it were practicable to ascertain to what part of India particular fractions of income (and therefore the incidence of the taxation burden) properly adhere, it is still arguable that in a Federation other considerations are also involved, particularly if the benefits and incidence of other forms of common taxation are unequally divided as between the various partners.'

[1] We have already indicated Sir Otto Niemeyer's views on the position of railways and his plea for a thoroughgoing overhaul of railway expenditure. See ch. v, §16.

§47 **The Niemeyer Report adopted.**—As was to be expected, the publication of the Niemeyer Report raised an almost universal storm of protest in India. All the Provinces, except the Central Provinces, as a matter of course attacked the Niemeyer plan and complained about their treatment in lengthy dispatches addressed to the Secretary of State. The Government of India also sent a dispatch to the same authority summing up their views. The Provincial representations in regard to the Niemeyer Award present a rowdy scramble. Each Province is inevitably convinced of the strength of its own claims and demands greater assistance from the Centre. Above the clamour of the Provinces the Government of India's dispatch shows how straitened its resources are bound to be by what it regards as the exceedingly, if not exclusively, generous help given by the Niemeyer plan to the Provinces.[1] The Provincial comments are reviewed in the following section. Lord Zetland in a dispatch (dated 20 May 1936) conveying to the Government of India the final judgement of His Majesty's Government upon the Niemeyer Report and the representations made by the Provincial Governments and the Government of India on that Report, says that he entirely accepts Sir Otto Niemeyer's conclusions and adds, 'It is my considered view that he (Sir Otto Niemeyer) has achieved as equitable a settlement between the various contestants as the case allows'. The Secretary of State and the Government of India thus regard Sir Otto's Report as in the nature of a quasi-arbitral award. The dispatch declares that such a nicely planned scheme could not properly be disturbed except for the strongest reasons. In the same dispatch the Secretary of State proposed 1 April 1937 as the date for the commencement of provincial autonomy. Accordingly Orders-in-Council were issued on 27 May 1936, relating to the distribution of the revenues and the commencement of provincial autonomy. The Order-in-Council relating to the distribution of the revenues reproduces the Niemeyer Award without alteration. The latter thus became a *fait accompli.* The Orders-in-Council were placed before Parliament on 12 June 1936.

§48. **Some comments on the Niemeyer Award.**—The Taxation Enquiry Committee were asked fourteen years ago to prepare a theoretically correct scheme of distribution of taxes between the Centre and the Provinces. They pointed out, however, that there was no such thing as a theoretically perfect scheme. A study of the financial systems adopted in the different federations would show how little pure theory has to do with the actual arrangements

[1] See *The Times of India*, 28 June 1936.

adopted in them, which have been determined mainly by the special circumstances attending the formation of each federation. Facts as they exist at the moment have to be reckoned with and will influence decisions more than dogma. Sir Otto Niemeyer's recommendations are characterized by a spirit of realism and practicalness and rather scant regard for theory as such. This attitude comes out clearly whether we consider Sir Otto's treatment of the question of subventions or export duties or the distribution of the proceeds of the income-tax. The recommendations represent a compromise between a number of conflicting aims and view-points and it is therefore not surprising that hardly any of the interested parties feel completely satisfied with them. In fact, it is suggested as a fairly reliable test of the soundness of such arbitral awards that all the parties concerned should regard them with mild dissatisfaction. The dissatisfaction with the Niemeyer Report is universal, and friendly critics plead that none of the contestants is acutely dissatisfied and that the Report does hold out a reasonable prospect of financial equilibrium both at the Centre and in the Units.

§49. **Provincial grievances.**—As was to be expected, some of the beneficiaries from the subventions complained that they had been treated in a niggardly fashion when compared with others. Thus Orissa feels aggrieved that whereas the subvention in its case is only Rs. 50 lakhs, it is Rs. 105 lakhs in the case of Sind. It is also complained that since the distribution of benefits has been governed by considerations of the actual needs of every Province rather than its deserts, the assignment of revenues to the Provinces is arbitrary and unjust. Those Provinces which have regulated their finances with economy and ability have come off worse than the spendthrift and incompetent Provinces. Bombay, for example, is aggrieved because due regard has not been paid to the years of painful thrift she was forced to practice as a result of the inequitable Meston Award. She bases her claim for a larger share of the income-tax on the additional ground that more than 25 per cent of the income-tax is realized in Bombay, and Bombay has to provide for many costly services for the benefit of her industrial population. Bombay further deplores that the distribution of the income-tax relief has been made entirely dependent upon the successful running of railways, and presses for the cancellation of the fictitious debt created in respect of unproductive irrigation works, financed from revenue and not from loans. The Government of Bombay protest that the relief to Bombay from separation from Sind is exaggerated. It is also argued on her behalf that if Bengal is to benefit from the jute export duty, she ought to benefit from the cotton duties. Similarly Madras feels she is

entitled to more because, e.g., even on a population basis she should get something like 24 per cent of the income-tax instead of the 20 per cent that is recommended. The Madras Government contrast Provinces like Bengal which have taken least care in balancing their budgets with themselves, and complain that Bombay gets too big a share of the income-tax. Bihar puts in its claim as the poorest Province and wishes that the basis of distribution should be a population one. The Punjab complains that too much has been made of the relief secured by her through the separation of the North-West Frontier Province many years ago and that the gratuitous assumption has been made that if the Frontier Province had continued as a division of the Punjab, it would still have remained as a serious burden to the parent Province. The Punjab fears that under the Niemeyer recommendations, its receipts from the Centre will be less than they were in 1936 by about Rs. 5 lakhs per year. The United Provinces casts envious eyes at 'the big slices given to Bengal and Bombay' and urges that it ought to get more help from the Centre as well, at the expense of the industrial Provinces.

To all these complaints we fancy that Sir Otto would reply by pointing out that the arguments on which the Provinces base their claims are theoretically unsound. In dealing with the supposed rights to income-tax in relation to population or place of origin and with the question of the jute export duties, the Report hints at the theoretical weakness of some of the usual arguments advanced in these connexions.

Sir Otto would perhaps also further point out that so long as the partners in the new political experiment are assured of solid advantages from the Federation it would be unwise on their part to insist on meticulous equality or strict distributive justice.

It may be that in the past some of the Provinces have been guilty of improvidence and extravagance. Nevertheless all must now be made to start even as far as possible, and ideas of retributive justice are wholly out of place.

The Provinces which have ordered their affairs with care and economy must seek consolation in the reflexion that at least in the future they will be allowed to enjoy the full benefit from their thrift and wise management and that virtue will at last be rewarded.

It is not suggested that some of the Provincial grievances are not well-founded and remediable. But it is almost impossible to make out an unanswerable case for revision. It is so easy to meet one set of clichés by another equally respectable!

One obvious fact which should be remembered is that to give more to one party means giving less to the others, that is the other Provinces or the Centre, and the need of the latter may be more

urgent or it may be for the common interests of the nation that it should be adequately met.

§50. **Central needs.**—It is most important that the Provinces should be armed with adequate spending power for the service of the nation-building departments and it is perfectly true that the needs of the Central Government are comparatively speaking stationary and its resources may also be stationary. At the same time Sir Otto Niemeyer is right in insisting upon the stability and adequacy of Central finances as a fundamental necessity. The Centre must have enough money for its essential all-India purposes such as maintaining the credit of the country, defending the country from external aggression and internal commotions. It must also be remembered that without complete assurance of Central solvency the Indian States would be averse to joining the Federation, that under the new regime the Central Government will be required to incur a certain amount of extra expenditure, e.g. in connexion with the establishment of the Federal Court, that some of its resources are no longer so reliable as they used to be,[1] and lastly that although relatively to the Units its functions will always be narrow, they are likely to be wider in an absolute sense owing to the closer contact with the Provinces which modern improvements in communication have made possible and the modern bias in favour of state intervention and central direction.

As Sir James Grigg pointed out in his 1938 Budget Statement, the Central Government has relinquished more than Rs. 20 crores of revenue to the Provinces since the War. Moreover in following a protective policy to the extent that has been done the Central Government has not found it easy to make up losses due to reduced import duty receipts.

The military and naval expenditure also may increase, however much we may deplore such a development, owing to untoward international developments which are threatening the world. To admit this as a possibility or even a probability, however, is not to accept as authoritative Sir Otto Niemeyer's opinion that it is not possible—even under existing conditions apart from any extraordinary developments—to reduce the *present* military expenditure. So far as this question is concerned our discussion of it above (see §19) stands unaffected by Sir Otto's *obiter dictum*. We call it an *obiter dictum* because military expenditure was not a subject into which Sir Otto was called upon specially to inquire, nor can he claim any expert authority for his views on it. He must merely be regarded as having taken the official assurances on the

[1] For example, customs are likely to yield less because of the depression and the policy of protection, and the railways are an uncertain factor.

matter at their face value and having (quite rightly) decided to err on the side of safety in assuming that no further reduction of the present expenditure was possible.

Similarly Sir Otto's justification of the surcharges on customs and income-tax and the endorsement of the same by the Secretary of State are not likely to be accepted without question in view of the Government's solemn pledge about their removal. The general scheme of Indian taxation may be in favour of the wealthier classes as stated by Sir Otto, but the retention of the surcharges will not be accepted as a suitable correction of this anomaly because they are felt to press with undue severity on classes of people who deserve sympathy and relief.

§51. **Concluding observations on the Niemeyer scheme.**—The success of Sir Otto's scheme, especially that part of it which is concerned with the sharing of the income-tax proceeds between the Centre and the Provinces, depends on the satisfactory working of the railways. The Provincial Governments will in their own interests have to co-operate with the Government of India in restoring the prosperity of railways and make them once more substantial contributors to the general revenues. This involves the regulation of the Provincial road policy so that the roads should assist instead of competing with the railways. It also involves a 'thoroughgoing overhaul of railway expenditure' on the part of the Central Government and a proper co-ordination of the different forms of transport. (See ch. v.)

As one critic remarked, at the time the Niemeyer proposals were made (1936) they had only an academic interest for the Provinces, because the share of the income-tax proceeds would not begin to be available until after ten years. Till then the Provinces would have to pursue, as rigorously as ever, the policy of retrenchment and economy. If they wished to realize any of their 'nation-building' ambitions they could only do so by resorting to fresh taxation, the prospects for which did not appear to be very bright.

Happily for the Provinces, these gloomy forebodings have not been justified. The realization of the Railway surplus in 1937-8 together with the suspension of railway liabilities (see ch. v) and the improved revenue position of the Central Government have enabled them to commence the assignment of income-tax to the Provinces under the Niemeyer Award with effect from the financial year 1937-8. On the basis of the estimates available on 22 March 1938, the amounts payable to the Provinces were as follows:

Bombay Rs. 25 lakhs, Bengal 25, Madras 18·75, United Provinces 18·75, Bihar 12·50, Punjab 10, Central Provinces 6·25,

Sind 2·50, Orissa 2·50, Assam 2·50 and North-West Frontier Province 1·25, the total amount thus payable being Rs. 1,25 lakhs. Even Sir Otto Niemeyer did not expect the Provincial Governments to obtain any share in the income-tax until after five years from the inauguration of Provincial Autonomy. The new Income-tax Bill, if passed, will further accelerate this process.

In conclusion we may welcome Sir Otto Niemeyer's proposals as an honest attempt on the part of an acknowledged financial expert to solve a difficult and complicated problem. We must, however, learn wisdom from the fate of previous expert recommendations on this tangled subject and not be too confident of the success of Sir Otto's scheme. It may reasonably be presumed to be an improvement on the earlier schemes, if only because it has had more experience to go upon. But after all its success depends upon a number of incalculable factors—the general economic condition of the country, the fortunes of the railways and the developments in the international situation. The economic recession during recent months abroad as well as in India, which has adversely affected our trade and railway earnings, emphasizes the need for an attitude of chastened optimism, not to speak of the very unstable international situation.

§52. **Statistics of Provincial finance.**—The following four tables illustrate the financial position of the Provinces individually as well as in the aggregate.

TABLE I[1]

TOTAL REVENUE AND EXPENDITURE OF PROVINCES

In crores of rupees

Year	Revenue	Contributions to Central Government	Retained Revenue	Expenditure	Surplus + Deficit −
1921-2	80·26	9·83	70·43	79·16	−8·73
1922-3	84·94	9·20	75·74	77·23	−1·49
1923-4	88·05	9·20	78·85	76·09	+2·76
1924-5	90·48	9·20	81·28	78·41	+2·87
1925-6	93·71	6·20	87·51	85·89	+1·62
1926-7	91·60	5·17	86·43	90·17	−3·74
1927-8	93·29	...	93·29	91·50	+1·79
1928-9	91·49	...	91·49	92·91	−1·42
1929-30	94·58	...	94·58	93·80	+0·78
1930-1	83·08	...	83·08	94·25	−11·17
1931-2	83·18	...	83·18	86·70	−3·52
1932-3	84·35	...	84·35	85·67	−1·32
1933-4	82·85	...	82·85	85·90	−3·05
1935-6	89·02	...	89·02	88·69	+0·33
1936-7	92·34	...	92·34	91·55	+0·79

[1] See *Simon Commission Report*, vol. II, par. 254; and *Finance and Revenue Accounts of the Government of India* (1936-7).

TABLE II[1]

Revenue of the Several Provincial Governments for the Year ended 31 March 1937

In lakhs of rupees

Heads of revenue	Madras	Bombay	Bengal	United Provinces	Punjab	Burma	Bihar	Central Provinces and Berar	North-West Frontier Province	Assam	Orissa	Sind	Total Provincial Governments[2]
Principal heads of revenue—													
Taxes on income ...	...	...	...	...	...	...	...	...	...	3·16	0·57	...	3·73
Salt[3] ...	...	0·02	0·55	0·01	...	1·07	0·27	...	...	0·06	0·02	...	2·00
Land revenue ...	4,65·59	3,44·32	3,54·00	5,64·69	2,96·74	5,05·70	1,36·14	2,54·45	21·67	1,29·76	50·26	40·57	31,71·13
Excise ...	3,95·58	3,25·29	1,36·36	1,52·78	1,03·58	89·52	1,16·10	63·80	9·09	35·90	32·78	34·95	14,98·52
Stamps ...	1,95·08	1,46·99	3,02·35	1,62·59	89·85	41·67	97·34	50·22	8·14	18·29	17·32	18·85	11,49·44
Forest ...	48·29	47·72	18·36	44·36	22·46	1,42·64	5·65	47·64	4·36	18·85	4·28	7·28	4,25·20
Registration ...	30·69	15·04	23·97	10·35	9·31	3·38	12·69	4·94	0·68	1·63	2·14	2·01	1,16·91
Scheduled taxes ...	0·82	19·72	16·89	...	0·43	14·13	...	0·03	...	...	...	1·06	53·84
Total ...	11,36·05	8,99·10	8,52·48	9,34·78	5,22·38	7,98·11	3,68·19	4,21,08	43·94	2,05·65	1,07·37	1,04·72	64,20·77
Railways ...	...	...	0·38	1·04	...	...	...	...	...	...	...	...	1·42
Irrigation ...	2,16·10	20·06	−0·31	1,51·85	4,41·83	32·17	21·95	4·21	12·51	...	4·16	89·95	9,94·64
Debt services ...	25·18	93·34	7·20	11·93	9·34	2·42	6·96	3·98	0·73	0·44	0·28	3·70	1,65·52
Civil administration ...	1,26·16	1,29·01	94·37	51·59	74·31	49·11	32·23	23·40	10·24	13·84	4·87	11·18	6,22·49
Civil works ...	37·43	38·83	20·90	22·15	32·32	23·27	10·39	13·01	5·85	21·93	1·50	3·37	2,33·75
Miscellaneous ...	17·12	59·46	2,39·37	18·66	46·88	23·97	18·21	5·04	1,02·06	11·52	52·18	1,87·43	7,95·18
Total Revenue ...	15,58·04	12,39·80	12,14·33	11,92·00	11,27·06	9,29·05	4,57·93	4,70·72	1,75·33	2,53·38	1,70·36	4,00·35	92,33·77

[1] *Finance and Revenue Accounts of the Government of India* (1936-7), Table No. 8.

[2] Includes totals of Shan States Federation (Burma) and Coorg.

[3] Provincial Governments' share of additional import duty on foreign salt.

TABLE III [1]

Expenditure of the Several Provincial Governments for the Year ended 31 March 1937

In lakhs of rupees

Heads of expenditure	Madras	Bombay	Bengal	United Provinces	Punjab	Burma	Bihar	Central Provinces and Berar	North-West Frontier Province	Assam	Orissa	Sind	Total Provincial Governments [2]
Direct demand on the revenue.	1,22·71	1,23·38	92·92	1,31·09	73·64	1,32·27	35·66	65·88	7·87	35·05	14·68	26·25	8,69·08
Forest and other capital outlay charged to revenue ...	3·02	0·49	0·20	0·33	4·94	0·55	0·31	0·65	...	0·44	0·17	0·03	11·02
Railway (revenue account) ...	...	...	...	0·07	...		...		...	0·44	...	...	0·51
Irrigation (revenue account)...	1,23·54	48·20	31·16	1,05·70	1,34·24	30·93	12·76	27·70	14·64	0·62	13·53	1,65·23	7,08·70
Irrigation capital outlay (charged to revenue) ...	2·31	...	...	−0·70	...	...	...	0·14	...	...	0·04	...	1·78
Debt services	−0·87	1,62·45	28·15	61·52	−13·28	18·57	5·87	9·92	0·63	16·82	−0·61	7·74	2,98·44
Civil administration—													
General administration ...	2,67·38	1,00·32	1,34·00	1,43·40	1,04·75	96·03	61·80	66·40	20·92	28·41	26·30	20·93	10,77·21
Administration of justice ...	92·26	61·05	97·38	69·53	51·63	53·08	34·86	26·27	7·44	9·72	6·38	11·93	5,22·23
Police	1,58·04	1,39·98	2,26·82	1,64·93	1,23·53	1,49·93	69·91	59·03	32·42	30·17	21·88	38·88	12,18·03
Education	2,55·61	1,58·58	1,31·52	2,05·19	1,57·17	77·66	68·76	51·61	21·28	34·66	25·45	27·55	12,18·86
Medical	90·60	40·41	49·45	33·24	44·83	38·92	20·82	14·61	6·99	13·68	7·82	7·10	3,70·77
Public Health	23·76	22·45	34·28	21·80	10·99	9·94	10·00	3·58	1·33	7·10	2·00	2·07	1,49·89
Agriculture	41·77	21·84	26·61	36·17	55·10	17·03	18·25	15·97	5·06	7·89	3·03	7·88	2,57·23
Industries	22·40	6·48	14·33	14·58	14·33	1·49	8·68	2·83	0·15	2·24	1·46	0·59	89·56
Other departments ...	85·53	42·99	51·44	30·81	33·12	36·91	19·72	10·50	10·41	6·11	3·07	6·63	3,38·04
Total ...	10,37·35	5,94·10	7,65·83	7,19·65	5,95·45	4,80·99	3,12·89	2,50·80	1,06·00	1,39·98	97·39	1,23·56	52,41·92
Civil Works	1,34·28	1,09·02	93·18	68·70	1,55·50	96·44	43·27	59·02	33·94	61·08	15·45	11·89	8,98·69
Miscellaneous	1,55·03	1,61·83	1,62·72	1,42·90	1,33·06	1,38·93	65·27	67·14	16·74	37·73	14·92	25·34	11,24·93
Total expenditure ...	15,77·37	11,99·47	11,74·16	12,29·26	10,83·55	8,98·68	4,76·03	4,81·25	1,79·82	2,92·16	1,55·56	3,60·04	91,55·07
Total revenue	15,58·04	12,39·80	12,14·39	11,92·00	11,27·06	9,29·05	4,57·93	4,70·72	1,75·33	2,53·37	1,70·36	4,00·35	92,33·77
Surplus (+), **Deficit** (−) of each Government ...	−19·33	+40·33	+40·23	−37·26	+43·51	+30·37	−18·10	−10·53	−4·49	−38·79	+14·80	+40·31	+78·70

[1] *Finance and Revenue Accounts of the Government of India* (1936-7), Table 9.

[2] Includes totals of Shan States Federation (Burma) and Coorg.

TABLE IV[1]

PROVINCIAL BUDGETS IN 1930-1, 1935-6 AND 1936-7

In lakhs of rupees

	Madras	Bombay	Bengal	United Provinces	Punjab	Bihar and Orissa	Central Provinces	Assam	North-West Frontier Province
Population (in millions)	46·7	21·9	50·1	48·4	23·6	37 7	15·5	8·6	2·4
1930-1—									
Revenue	16,84	13,81	9,66	11,97	10,56	5,27	4,70	2,44	...
Expenditure	17,90	15,62	11,41	12,88	10,99	6,06	5,14	2,79	...
	−1,06	−1,81	−1,75	−91	−43	−79	−44	−35	...
1935-6 (Revised)—									
Revenue	15,72	14,80	11,43	11,79	10,46	5,54	4,56	2,36	1,70*
Expenditure	16,04	15,08	11,58	11,84	10,57	5,61	4,81	2,83	1,76
	−32	−28	−15	−5	−11	−7	−25	−47	−6

	Madras	Bombay	Bengal	United Provinces	Punjab	Bihar	Central Provinces	Assam	North-West Frontier Province	Orissa	Sind
Population (new boundaries) (in millions)	44 0	18·0	50·1	48·4	23·6	32·4	15·3	8·6	2·4	8·3	3·9
1936-7 (Estimates as presented)—											
Revenue	15,90	12,04	11,49	11,71	10,80	4,70	4,81	2,37	1,70*	1,63*	3,13*
Expenditure	15.90	12,03	11,91	12,45	10,78	4,82	4,90	3,00	1,80	1,63	3,13
	...	+1	−42	−74	+2	−12	−9	−63	−10	...	...

[1] See *Indian Financial Enquiry Report*, by Sir Otto Niemeyer, p. 18.

* Including subvention from Government of India.

Table I above shows that the expenditure in the Provinces has risen substantially, the rise between 1923-4 and 1928-9 being no less than 22 per cent as compared with an increase of only 4 per cent in the revenue. The continued increase in Provincial expenditure was made possible by the remission of Provincial contributions, the benefit of which, however, was confined only to a few of them. Since 1930-1, while Provincial revenues received a setback owing to the severe economic depression, there was no corresponding reduction in expenditure, and a succession of deficit years was inevitable. The position has improved in recent years, at any rate in some of the Provinces.

Tables II and III give the detailed particulars of the revenue and expenditure of the several Provincial Governments in the year 1936-7. They also show the relative importance of the various heads of revenue and expenditure in the different Provinces. Table IV shows at a glance Provincial Budgets in 1930-1, 1935-6 and 1936-7 (inclusive of the budgets of the newly created Provinces of Orissa and Sind), giving also population figures for comparison. The table will be found useful in considering the financial adjustments recommended by Sir Otto Niemeyer (see §40 *ante*).

Local Finance

§53. **Local (Rural) Boards.**—Since nearly 90 per cent of the population of British India lives in rural areas, far greater importance attaches to District and Sub-District Boards than to the municipalities which serve the numerically insignificant urban population. At one time Provincial Rates or surcharges on land used to be an important item in the budget in the Central Government. Today, however, they form a substantial part of the revenues of District and Local Boards, representing a proportion of total income varying from 25 per cent in Bombay to 63 per cent in Bihar and Orissa (in 1922-3). They were originally started in Bombay and Madras between 1865 and 1869 and were levied on land chiefly for the construction and repair of roads, the upkeep of schools and dispensaries, village sanitation and other local expenditure. The principle was extended in pursuance of Lord Mayo's scheme of financial decentralization. In 1871 Acts were passed levying similar cesses in Bengal, the United Provinces, and the Punjab. In the Punjab and Oudh, cesses for roads, schools and the District post, assessed at the time of the land revenue settlement, were continued side by side with the new general cess. Similar settlement cesses were introduced in the Central Provinces, Burma and Assam, which were later replaced by a general cess. Between 1871 and 1905, there were added certain cesses for Imperial purposes. The

Famine Insurance Fund was instituted in 1878, to which were added, in some Provinces, cesses for Provincial purposes, chiefly for the payment of village officers. The financial improvement in the position of the Government of India made possible the abolition in 1905-6 of all cesses levied for other than local purposes. In some cases, however, the effect of this reform was not to reduce the amount of the cesses levied, but to transfer the fund from Provincial to local purposes, the Provincial Government being compensated from the Imperial Treasury. Recently there has been a tendency in some Provinces either to increase the general rate or, as in Madras, to add new cesses for specific local purposes such as elementary education. The basis of these local cesses on land varies with the system of land revenue. Thus in the ryotwari areas of Bombay, Madras, Burma, the Central Provinces and Berar, and in the temporarily settled areas of Assam, the cess is levied on the basis of land revenue. In the United Provinces and the Punjab, on the other hand, the annual value is taken with twice the land revenue as the basis. In the permanently settled areas either the rental value or the acreage is accepted as the basis. As regards the rates of the cesses they are left to the discretion of the local bodies, subject to certain maxima and minima laid down by the Provincial Legislatures. The land cesses are collected along with the land revenue but are largely administered by the local bodies. The limits vary from 6¼ per cent to 12½ per cent.[1] The land cess, although it is not proportioned to ability to pay, being levied at a flat rate, is everywhere recognized as an appropriate tax as it is applied for the benefit of the properties which gain by the activities of the Local Boards. We have already referred to the recommendations of the Taxation Enquiry Committee that the land revenue should be standardized at a low rate so as to leave a wider margin for local taxation.[2]

The subjoined table indicates the principal sources of revenue and items of expenditure and the aggregate revenue and expenditure of District and Local Boards in British India.[3]

[1] According to the Layton Report there is no longer any excuse for the retention of the maximum (which in some Provinces has been one anna in the rupee, and has remained unchanged for over fifty years) because (i) the land revenue no longer represents a very high proportion of the net produce, especially in the permanently settled Provinces, and (ii) all the other cesses on land have been abolished. See *Simon Commission Report*, par. 275.

[2] See vol. I, ch. xii, §35.

[3] These figures represent the aggregate revenue and expenditure of 1,144 and 1,098 Boards (including Union Panchayats in Madras) in 1915-16 and 1934-5 respectively. See *Statistical Abstract for British India*, 1923-4 and 1935-6.

In lakhs of rupees

Income (excluding balances)	1915-16	1934-5	Expenditure	1915-16	1934-5
Provincial rates ...	3,39	5,39	Education ...	1,82	6,08
Civil Works ...	1,43	2,06	Civil Works ...	4,16	4,05
Other sources ...	2,68	8,72	Sanitation, Hospitals, etc. ...	70	2,01
Total ...	7,50	16,17	Debt and Miscellaneous	1,32	3,78
Incidence per head .	RS A P 0 5 1	RS A P 0 9 8	Total ...	8,00	15,92

The above table shows an increase of income from Rs. 7·50 crores in 1915-16 to Rs. 16·17 crores in 1934-5. But as this income has to be divided among 1,098 Boards, the poverty of an average Board stands out clearly.

§54. **Municipal finance.**—As seen from the table on p. 601, the main source of the income of municipalities is rates and taxes, which account for about two-thirds of the total municipal revenues. The remaining one-third is derived from municipal property, contributions out of Provincial revenues and miscellaneous sources. The taxes levied by the local authorities may be grouped under four heads: (i) Taxes on trade, for example octroi duties, terminal taxes, tolls, etc.; (ii) taxes on property, for example taxes on houses and their sites (and in rural areas the cess on land); (iii) taxes on persons, for example taxes on circumstances, professions, trades and callings, on pilgrims, on menials and domestic servants, etc.; and (iv) fees and licenses. Fees are either for specific services rendered by the municipality, such as scavenging fees, or are partly of the nature of luxury taxes and partly levied for purposes of regulation, such as licenses for music, vehicles, dogs and other animals, etc. There are also license fees for offensive and dangerous trades. The Taxation Enquiry Committee point out that considerable vigilance is necessary in respect of indirect taxes, such as taxes on trade taking the form of octroi, terminal taxes and tolls, so as to prevent undue interference with inter-Provincial traffic. Special objection is taken to the octroi and terminal taxes which offend against all the canons of taxation, and substitutes such as a tax on retail sales or profession taxes are suggested. At any rate a judicious modification of the present system of octroi duties is necessary. Another important suggestion of the Committee is in favour of increased assessment of town property which benefits largely from municipal activities. The machinery for collection and assessment, however, would have to be far more efficient for this purpose than it happens to be today.

The heaviest items of expenditure, as the table below shows, are public health and convenience, public works and education. The municipalities are often unable to meet their expenditure from ordinary revenues and have generally therefore to borrow money, either from the Government or in the open market, to carry out such large projects as water supply, drainage works, etc. The borrowings of the Bombay Municipality are the biggest, its loan liabilities on 31 March 1937 amounting to Rs. 15·65 crores.

The following table illustrates the financial position of municipalities in British India.[1]

In lakhs of rupees

	1915-16	1934-5
SOURCES OF INCOME		
Municipal Rates and Taxes: Octroi ...	1,45	1,49
Taxes on houses and lands	1,87	5,30
Tax on animals and vehicles	21	47
Tax on professions and trades	18	32
Tolls on roads and ferries	17	24
Water rate	97	2,07
Lighting rate ...	15	26
Conservancy rates ...	61	1,20
Other taxes	19	1,79
Total rates and taxes	5,80	13,14
Realizations under special Acts ...	11	17
Grants from Government	84	95
Rent of lands, houses, etc.	23	52
Fees	38	1,02
Receipts from markets and slaughter houses	47	94
Other sources and miscellaneous ...	85	1,45
Total Income ...	8,67	18,19
Extraordinary and Debt :	6,44	19,89
Grand Total ...	15,11	38,08
Incidence per head	RS. A. P.	RS. A. P.
(i) Rates and Taxes	3 5 9	5 12 0
(ii) Total income, excluding Extraordinary and Debt	5 0 3	7 15 3

	1915-16	1934-5
HEADS OF EXPENDITURE		
General Administration and collection charges ...	76	1,77
Public Safety:		
Lighting	43·7	1,19
Police	0·4	1
Fire, etc.	9·1	15
Total ...	53·2	1,35
Public Health and Convenience—		
Water supply, drainage and conservancy ...	3,32	4,85
Hospitals and dispensaries and vaccination ...	50	94
Plague charges, markets, gardens and sanitary ...	50	95
Public works ...	1,42	2,06
Public instruction ...	62	2,25
Contributions for general purposes ..	27	77
Miscellaneous:		
Interest on loans	77	1,70
Other miscellaneous expenditure ...	43	1,19
Total Expenditure	9,12·2	17,83
Extraordinary and Debt :	6,33·0	19,77
Grand Total ...	15,45·2	37,60

[1] These figures represent the aggregate revenue and expenditure of 714 and 798 Municipalities in 1915-16 and 1934-5 respectively. See *Statistical Abstract for British India* (1935-6), Tables No. 34, 35.

Since the total income indicated in the above table is distributed among as many as 798 municipalities, it is obvious that the average municipality in India must be very poor in resources. The Bombay Corporation alone has an income of over Rs. 3 crores, and the Calcutta Corporation an income of over Rs. 2¼ crores. While Bombay and Calcutta, however, stand head and shoulders above an average municipality in this country in point of the size of revenue they enjoy, they cannot stand comparison, for instance, with the city of Glasgow which, with a population approximately equal to that of Calcutta, has twelve times the income of Calcutta.

§55. **Inadequate resources of local bodies.**—It is not necessary here to trace the progress of local self-government in India since its inception in Lord Mayo's time. We shall confine ourselves to a discussion of the financial position in recent times of the local self-governing bodies—urban (municipalities) and rural (rural boards). With the inauguration of the Reforms and the transfer of Local Self-Government to ministers, the question of local finance has come into increased prominence. Considering the devolution of powers to local bodies that has taken place and the wide range of functions assigned to the municipalities, rural boards and panchayats, such as Public Health, Education, etc., the resources of these bodies are at present utterly inadequate. It is impossible for them to introduce modern standards of administration unless they are put on an ampler financial basis.[1] Under the new constitution (1919 and 1935), the local bodies are called upon to meet expenditure on services previously rendered gratis by Government servants belonging to the various departments. Also, in the first flush of enthusiasm the local bodies forgot that 'all undertakings depend upon finance',[2] and launched costly and ambitious schemes of education, medical relief, etc., which were beyond their powers. The financial difficulties thus caused have recently been met partly by retrenchment, partly by additional taxation and partly also by a more careful distribution of the available resources.

§56. **Causes of inadequacy of resources.**—Apart from the general low taxable capacity of the people and their alleged unwillingness to tax themselves for local purposes, another important factor explaining the inadequacy of local resources is the unfair distribution

[1] The poverty of our local bodies stands in marked contrast with the rich resources of similar bodies elsewhere. For example, as the Simon Commission point out, 'local rates of all kinds, urban as well as rural, produced in 1927-8 in British India about £12½ millions, which is only little more than the income from rates in that year of the London County Council alone.'—*Simon Commission Report*, vol. I, par. 377.

[2] Kautilya's dictum adopted as a motto by the Taxation Enquiry Committee.

of revenues between the Central, Provincial and local authorities. In England the bulk of the contribution from land goes to the local bodies, the Central Government receiving only a very small amount as land tax. One of the reasons for the financial weakness of the local bodies in India is that the local bodies have developed by the process of devolution of powers instead of the process of a federation of strong, semi-independent smaller units into larger political units. Another reason is that the jurisdictions of the local bodies are usually so extensive as to remove them from effective touch with tax-payers. Had it not been for this, the imposition of taxes on houses and persons by local bodies in the villages would have been easier. From this point of view, the restoration of the influence of the village panchayats and a limitation of the functions of the bodies at present operating would be desirable.

§57. **Improvement of resources.**—Though the recommendations of the Decentralization Commission and the introduction of the Reforms (1919) have led to considerable financial freedom being conferred upon local authorities, there has been no material exchange so far as the nature of the taxes imposed is concerned except that the taxes which may be levied without the sanction of the Government of India have been specified in the Scheduled Taxes Rules.[1] The Taxation Enquiry Committee make the following recommendations with a view to increasing the resources of the local bodies: (i) conversion of the *thathameda*,[2] the capitation tax and the *chowkidari* into sources of local revenue; (ii) standardization of the land revenue at a low rate so as to give better scope for local taxation; (iii) transfer to local bodies of a share of the collection of Provincial Governments from ground rents in towns and from an increase in the rates of non-agricultural land; (iv) empowering municipalities to tax advertisements; (v) extending the scope of taxes on entertainment and betting; and giving local bodies a substantial share of the proceeds; (vi) extending and improving the administration of the taxes on circumstances, property and professions; (vii) reducing the import duty on motor cars and enabling the Provincial Governments to levy a provincial tax in lieu of tolls for distribution to local bodies; (viii) empowering local bodies in selected areas to levy a fee for the registration of marriages; and (ix) supplementing the

[1] The Scheduled Taxes which the local authorities can impose under these rules are tolls; taxes on land and land values; taxes on buildings; on vehicles or boats; on animals; on menials and domestic servants; octroi duties and terminal taxes; taxes on goods imported into or exported from a local area; taxes on trades, professions and callings; taxes on private markets, taxes for services rendered, for example, water rate and drainage tax; and fees for the use of markets and other public conveniences.

[2] General tax on land in Burma.

resources of local authorities by subsidies which should be ordinarily restricted to services of national importance and granted in such a way as to enable the Provincial Government effectively to enforce efficiency.[1] Another way of increasing the resources of the local bodies is to extend the scope of municipal trading and enterprise so as to lessen the existing dependence on taxes. In view of the comparative inelasticity of the local taxes it is desirable to make use of non-taxation sources to a larger extent than at present. In western countries, the scope of municipal domain—landed estates and especially industrial and trading domain—is on the increase and there are municipal tramways, waterworks, gas and electric works, burial grounds, bathing establishments, fisheries, docks, bakeries, theatres, inns and restaurants, mills, factories, dairies, etc. All these enterprises are apparently not only rendering effective service to the civic population but are also a substantial source of revenue for the municipalities.[2] This aspect of local finance has been entirely neglected in India and it appears worth while for the local bodies to explore its possibilities so as to add to their slender resources and increase the amenities of civic life.

[1] *Taxation Enquiry Committee Report*, pars. 194-6.

[2] Shah and Bahadurji, *Functions and Finance of Indian Municipalities*, p. 434.

CHAPTER XII

UNEMPLOYMENT

§1. **Scope of the chapter.**—A permanent margin of unemployment among industrial workers is a feature of the economic system called into existence by the Industrial Revolution in western countries. Certain palliatives, such as unemployment insurance allowances and poor relief funds, have come into use more or less in these countries, without however touching the fundamental cause of unemployment, namely, a maladjustment between production and consumption inseparable from the existing individualistic system of competitive production for world markets. The post-War depression in industry has created an unemployment situation of unprecedented magnitude. But though the evil has manifested itself on a scale unknown in the past, the phenomenon of industrial unemployment itself is sufficiently familiar in the west.

With us here in India, the problem of unemployment presents aspects which, while equally difficult to tackle, are somewhat different from those found in western countries. In the first place, the vast majority of the population depends upon agriculture, and we have already seen that, in most parts of India, there is seasonal unemployment in agriculture for five to nine months in the year during the slack season; and we have discussed the question of suitable supplementary industries to keep the cultivator occupied during this period of enforced idleness. But a more serious aspect of the unemployment problem presents itself in connexion with the periodical occurrence of scarcity or famine, due to a partial or total failure of the monsoon, leading to a partial or complete stoppage of agricultural operations over wide areas, and disengaging a vast quantity of agricultural labour and of labour employed in industries subsidiary to agriculture. This is by far the most serious form of unemployment to which India is liable.

Turning to occupations and industries other than agriculture, we may distinguish between the manual or hard-handed workers, and the intellectual and clerical or soft-handed workers constituting the so-called educated middle class. Regarding the former category of industrial workers, it is clear that unemployment among them, though not unknown, does not as yet exist on the western scale for the simple reason that our industrial development is as yet in its infancy. So far as we have any modern industries at all, they have been caught up in the world-wide depression, and there exists at

the present moment a good deal of industrial unemployment in India also. Owing to the closure of workshops and factories, or retrenchment in them, a number of operatives, skilled and unskilled, are without work. But in more normal times the complaint is rather that there is scarcity of industrial labour than that there is unemployment among its ranks. Moreover, unemployment when it does come has not the same terrors for the operatives in India as in the west, owing to the fact that most of our industrial labour has predominant agricultural interests. Often indeed work in a factory is regarded as a second string to the bow and is taken up only during the slack agricultural season. Industrial unemployment in India differs from the corresponding phenomenon in the west not only as regards the scale but also as regards the nature of the problem it creates for the State. To a certain extent the problem is automatically solved in India by many of the unemployed returning to their villages. The distress is in this way merely *transferred* from the industrial to the rural areas, and not really remedied. But it at least largely disappears from sight so far as the industrial centres are concerned and one does not see as in Europe shoals of the unemployed walking the streets of our industrial cities in vain search of work.

As distinguished from unemployment among industrial workers in organized industries, there is some unemployment among cottage workers. In our chapter on the economic transition in India[1] and our discussion of the position of cottage industries,[2] a general idea has already been obtained as to the manner in which the different classes of artisans have been affected by the transition, and we have formed some notion of the hardship and distress which have been the portion of many of them, who, having lost their old occupations, have not found a satisfactory substitute for them.

Another species of unemployment which is comparatively a modern growth in India is middle class unemployment, affecting those who have attained a certain standard of education and who depend more or less exclusively upon non-manual or clerical occupations. This is a problem that has recently pushed itself very much to the forefront.

In this chapter we propose to concentrate attention on rural unemployment due to famines and middle class unemployment.

Rural Unemployment: Famines and Famine Relief

§2. **Responsibility for famines.**—The frequent occurrence of famines in the last quarter of the nineteenth century accompanied by a political awakening of the people gave these calamities a

[1] Vol. I, ch. v. [2] Ch. ii, §§34-41.

prominence which possibly they would not have attained otherwise. Indian publicists attributed their severity to the industrial, financial and land revenue policy of the Government. By the great majority of people, the British Government came to be regarded as the sole cause of famines and this facile view of things was not disturbed by unimpeachable historical evidence of equally, if not more, severe famines in the pre-British days. This uncritical attitude elicited the cheap retort that famines were entirely due to failure of rains—a circumstance beyond the control of the British or any other Government. This, however, rather missed the point of the critics, who blamed the Government not for withholding rain but for causing the impoverishment of the people which made them incapable of resisting the effects of occasional scarcity. In this chapter, however, we are not concerned with locating the responsibility for Indian poverty but with the less contentious subject of the nature of Indian famines and the machinery devised to combat them.

§3. **Economic effects of famines.**—The economic effects of famines are bound to be disastrous in a preponderantly agricultural country like India. The heavy mortality due to sheer starvation which used to be a regular feature of the famines in the old days, has ceased to characterize modern famines, though the epidemics which still follow in the wake of famines send up the mortality figures very greatly.[4] There is a general lowering of the efficiency of the surviving people and the suspension of cultivation involves a great economic loss to cultivators. Food famines are often accompanied by fodder famines, and the resulting loss of cattle further hampers agriculture. There is also an adverse reaction on trade and industry because of the reduction in the purchasing power of large numbers of people. Public finance is greatly disorganized and the Government is hit hard both on the side of revenue which inevitably shrinks and of expenditure which equally inevitably expands.

§4. **History of famine relief.**[1]—It is wrong to suppose that in the pre-British days there were no famines at all or that they were less severe than in the present days. We read that in the famine of 1291 whole families drowned themselves as an escape from starvation, also that in the famine of 1555, people tried to live on the hides of dead beasts, and that the famine of 1630 actually led to cannibalism. In the face of these terrible records of well-authenticated facts, it is impossible to subscribe to the popular opinion that the British in some mysterious way brought famines with them to India. Famines on the contrary were more common

[1] For a brief, but excellent, treatment of famines in India, see A. Loveday, *The History and Economics of Indian Famines.*

in pre-British days while, owing to defective communications, the system of famine relief was inevitably less effective than at present. There were central granaries at the capitals which were originally maintained as war chests, but which in times of famines could be used to feed the starving poor. As communications were undeveloped, the village rather than the Central Government became the vital organization of society, and it was the surplus grain stored in the villages from which any relief could be expected. The efficacy of this arrangement depended on the intensity of the famine and its duration. The construction of public works like canals and tanks or the erection of temples, mosques, forts or palaces at public expense gave employment to a number of people and may have been useful in mitigating distress. Lastly, it may be believed that the kings occasionally attempted direct charity, which, however, from the nature of things could not have been anything but inadequate as a remedial measure. The present view as to the responsibility of the State in this matter is a very recent growth.

Coming to the British period, the most important famines during the regime of the East India Company between 1760 and 1857 were those of 1770, 1784, 1802, 1824 and 1837. Excepting the first in the list, these famines did not receive the same elaborate attention, either at the hands of the Government, or of the historians, as the famines of the latter half of the nineteenth century. The minds of people were preoccupied with other grave matters, such as the continuous wars, the widespread disorder caused by the sudden introduction of unfamiliar judicial and land revenue systems and a corrupt administration in the hands of ill-paid and inexperienced officials, unemployment on a large scale caused by the sudden demobilization of the troops of Indian princes, the depredations of the Pindaris, etc. The political and administrative preoccupations of the Company made it indifferent to the question of the economic regeneration of the people. Even if it had the opportunities, it is doubtful whether it would have had the will to do anything, because its whole outlook was vitiated by commercial considerations and it seemed to be more concerned with the dividends of its shareholders than with the lives of those from whom these dividends were drawn. The Company in the later years of its existence acknowledged in a general way its obligations to the famine-stricken people; but it failed to evolve any systematic famine policy. Slipshod and spasmodic efforts were made to deal with famines by regulating prices and trade in corn, encouraging emigration and occasionally undertaking public works. But all this was mere tinkering with a vast problem.

It is to the period following the transfer of India to the Crown in 1858 that we must turn for the elaboration of a proper system of prevention, insurance and relief evolved through many experiments and failures. In this period fall several great famines such as that of north-west India in 1860, of Orissa in 1865, of Rajputana in 1868, of Bihar in 1873, of South India in 1876 and the two widespread famines of 1896 and 1899-1900 which affected various parts of India, including Bombay, Madras and the Central Provinces. The Orissa famine of 1865 affected five crores of people and was responsible for a heavy mortality of ten lakhs. The Government were slow to take action in the beginning, though food was later poured in large quantities into the affected areas. The great loss of life in this famine led to an inquiry presided over by Sir John Campbell, and the Government announced their definite policy to save life at any cost. In the Bihar famine of 1873 the Government erred in the direction of indiscriminate charity and excessive expenditure. The great South India famine of 1876-8 involved a mortality of 52 lakhs. This led to the appointment of the first great Famine Commission presided over by Sir Richard Strachey, and on the measures taken by the Government of India at the instance of this Commission is based the subsequently elaborated machinery of famine relief. Among the steps taken by the Government may be mentioned the introduction in 1878 of a Famine Insurance Grant by which a sum of Rs. 1½ crores was provided in the annual budget of the Government of India to be spent on direct relief if there was a famine, and on the construction of public works of a protective nature if the year was normal; the extension of communications by the system of the 'new guaranteed railways'; the clear definition of the principles of famine relief as provision of work to the able-bodied at a wage sufficient to secure health but not ordinary comforts, and gratuitous relief to the infirm in their own villages or in poor-houses; assistance to the landowning classes by way of takkavi loans; and the suspension and remission of land revenue. Famine codes embodying these principles were made for every Province. These codes were put to a severe test during the famines of 1896-7 and 1899-1900 and were amended in the light of the experience then gained. The earlier of these famines were followed by the appointment of a Commission presided over by Sir James Lyall, which made certain recommendations for the relief of special classes like weavers and hill tribes, proposed rules for the management of charitable funds, advocated a freer grant of gratuitous relief in villages, but disapproved of the extension of decentralized relief works. The second of these famines came too rapidly on the heels of the first to allow the Government time to consider these

recommendations. In 1900 the Maharaja of Jaipur donated Rs. 16 lakhs to constitute the nucleus of the Indian Peoples' Famine Trust. In 1901 the last Famine Commission under Sir Antony Macdonell emphasized the importance of 'moral strategy' or 'putting heart into the people', that is, assisting the people by loans and other means immediately danger is scented, by the prompt and liberal distribution of takkavi, early suspension of land revenue, and a policy of 'prudent boldness' involving the preparation of a large and elastic plan of relief, constant vigilance and full enlistment of non-official help. The Commission further drew attention to the necessity of devising measures for tackling a fodder famine and of saving cattle. Lastly it recommended the starting of co-operative credit societies and the extension of State irrigation works of a protective character. The amended famine codes embodying these principles have well stood the test of subsequent famines, such as that of the United Provinces in 1907, of Ahmednagar in 1912, and the far more serious scarcity of 1918 and 1920, and these visitations of nature may now be said to have been brought more effectively under human control than ever before in the history of India.

§5. **Change in the nature of famines.**—One main cause why this satisfactory result has been brought about is that the nature of famines has entirely changed. The Special Commission of 1867 defined famine as 'suffering from hunger on the part of large classes of population', but the history of famines in India is largely a discovery of a change in the meaning of that word brought about by two main factors: first, the improved means of communication and transport by which deficiency in one part can be relieved by drawing upon the abundance in other parts; and secondly, the progressive perfection of the administrative organization dealing with famines.[1] We have now no such thing as a food famine, for although the rains may fail in one part, it is very rarely that this is not balanced by an exceptionally good monsoon somewhere else; and thus, taking the country as a whole, there is generally the usual quantity of food available. Since modern famines are not food famines but money famines, what the State is called upon to do is to provide work and wages on an adequate scale. At present a famine is more accurately described as a temporary dislocation of employment due to the failure of crops, than as widespread death from starvation. Famine relief therefore primarily consists in providing employment for those against whom nature has declared a temporary lock-out.[2] When ordinary employment

[1] See Loveday, op. cit.

[2] See Sir T. Morison, *Economic Transition in India*, p. 124.

fails, the Government open relief works on which practically everyone who seeks employment gets it and is able to earn enough by way of wages to enable him to buy just sufficient food.

§6. **Classification of causes and remedies.**—The causes of famines may roughly be divided into two kinds: (i) immediate and direct causes like drought or the after-effects of drought; and (ii) remote but fundamental causes which have to do with the intense poverty of the people and their consequent inability to resist the slightest disturbance of the normal economic life. The first kind of causes can be met by the adoption of measures for the alleviation of distress or by making wise provision beforehand and remaining always in a state of preparedness to meet the calamity. Storage of grain and fodder and all insurance schemes are instances of previous preparedness. To deal with the second kind of causes we must dig deep down into the fundamentals of the question of Indian poverty. The solution of this tremendous problem has to be approached from many sides and involves the adoption of an all-round intensive programme of economic regeneration.

§7. **Direct causes and remedies.**—The chief direct cause of famines being deficiency or total failure of rains, it would be clearly an advantage if the probable character of the coming monsoon could be foretold. The Meteorological Department keeps a regular record of the weather conditions prevailing in the different parts of the country. It is supposed that these data and especially a scientific study of the conditions prevailing in the upper strata of the air are capable of furnishing sufficient clues for making successful forecasts about the monsoon. Excessive rains and floods are also causes of famines, but the damage due to these can generally be repaired with comparative ease. Locusts and other insect pests and various kinds of fungi are often responsible for failure of crops. Government mycologists and other experts are engaged in fighting these causes.

§8. **Famine Insurance and Relief Funds.**—The precautionary measures against famine include the Famine Insurance Grant mentioned above. The Government of India used to allot funds out of this grant to the different Provinces according to their needs. Before the Reforms famine relief had come to be a regular divided head of expenditure, the Central Government bearing two-thirds, and the Provincial Governments one-third, of the expenditure. But after the financial decentralization that followed the Reforms of 1919 each Province was required to provide for its own famine insurance out of its revenues annually. The unspent grant formed part of the Central balances on which the Central Government

paid interest. The balances of the fund could be spent on (i) relief of famine, (ii) construction of protective works for prevention of famines, and (iii) grant of loans to cultivators. A scale of the Famine Insurance Fund was laid down, and each Provincial Government was required to contribute from its resources a fixed sum every year for Famine Insurance in proportion to its liability to famine. Thus while Bombay, the Central, and United Provinces contributed to the Famine Insurance Fund Rs. 63·60, 47·26, and 39·60 lakhs respectively, Bihar and Orissa, Madras and the Punjab contributed Rs. 11·62, 6·61 and 3·81 lakhs respectively. The contribution of Bengal was Rs. 2·00 lakhs, and of Burma and Assam, only Rs. 0·67 and 0·10 lakhs respectively. The aggregate contribution to the Famine Insurance Fund was Rs. 175·27 lakhs annually.

The constitution of the Famine Insurance Fund underwent a radical change with effect from the financial year 1928-9. Under the new regulations, the Fund ceased to be an Insurance Fund. It was called the Famine Relief Fund and it provided as its main object for expenditure on famine relief proper; the word famine being held to cover famine due to drought or other natural calamities. Accordingly, the annual assignment from the revenue, as well as the balances till they exceeded a certain amount, were not expended save upon the relief of famine. Loans to cultivators are not granted from the new Famine Relief Fund direct, though the Fund may advance money for financing the Provincial Loan Account if and when its balance exceeds the prescribed minimum. The balances at the credit of the old Famine Insurance Fund on 31 March 1928 were transferred to the new Fund on 1 April 1928. In Burma and Assam, where no Famine Relief Fund had been created, the balances at the credit of the old Famine Insurance Fund were transferred to the general balances of the Provinces. The total balance in the Famine Relief Fund on 1 April 1936 was Rs. 2,79,98,405; the additions during the year 1936-7 (inclusive of interest on the balances) Rs. 35,16,476; the total withdrawals, Rs. 22,23,984; and the closing balance on 31 March 1937 was Rs. 2,92,90,897.[1]

The new Constitution envisaged under the Government of India Act, 1935, contains no provision for a separate Famine Relief Fund. From the institution of Provincial Autonomy on 1 April 1937 the balances at the credit of the Fund have been handed over to the Provinces, and it has been left to Provincial Governments and their legislatures to take the measures hitherto prescribed for them.

[1] See *Finance and Revenue Accounts of the Government of India for the year 1936-7*, pp. 370-80 and 522.

Funds from t[illegible]an Famine Trust are used to help the poor from the superio[illegible] who cannot accept Government relief in the ordinary way. [illegible]eeting famines when they actually occur, however, the Government mainly rely on the relief organization which was evolved in the latter half of the nineteenth century. The increasing efficacy of this organization is attested by the comparative ease with which the people stood the strain of the severe famine conditions of 1918.

§9. **Description of relief measures.**—A brief description of this organization will give the reader an idea of the elaborateness of the machinery and of the minute care with which it has been perfected.[1] (i) Standing preparations are made on a large scale. Valuable information is gathered about climatic conditions, crops and prices, births and deaths; programmes of suitable relief works are kept ready and brought up to date; the country is mapped out into relief circles; and reserves of tools and plant are stocked. (ii) When rains fail, a careful look-out is kept for danger signals such as rise in prices, restlessness of the people, their aimless wandering, contraction of private charity, and increase in crime, especially petty thefts. (iii) The Government then take preliminary action and declare their general policy as based on moral strategy. Meetings are called at which Government policy is explained to the people, non-official help is enlisted, suspension of revenue is declared, and loans for agricultural improvements are made. Village inspection begins and preliminary lists of helpless persons are prepared. (iv) Then follows the first stage of actual relief. Test works are opened and, if considerable labour is attracted to them, they are converted into relief works on the principles laid down in the famine codes. (v) The next stage commences from December. Central relief camps are organized and gratuitous relief is given to the infirm in the villages. Poor-houses are opened in towns, and village kitchens are run for the benefit of children. The distress reaches its climax in May when there is fear of an outbreak of cholera. (vi) The last stage begins with the advent of the rains. The large relief works are closed down and people are moved in batches to smaller relief works near their villages so as to prevent the spread of epidemics and to facilitate the restoration of normal agricultural conditions without needless delay. Local gratuitous relief is extended and liberal advances are made to cultivators for the purchase of cattle, ploughs and seed. When the principal autumn crop is ripe, the few remaining works are gradually closed down and gratuitous relief ceases. The

[1] See *Imperial Gazetteer of India*, vol. III, pp. 477-81.

famine is ordinarily at an end by the middle of October. All this time the medical staff is kept ready to deal with cholera and malaria, diseases which generally appear when the rains break out.

§10. **Ultimate causes and remedies.**—The great poverty of the people is the ultimate cause of famines, and throughout this book we have been considering one or other of the numerous features of Indian poverty, such as the excessive reliance of the population on agriculture—an industry dependent on an uncertain rainfall—the decay of old industries and the absence of new ones, and a peasantry steeped in indebtedness, living from hand to mouth, without any reserve to fall back upon in times of scarcity. The remedies for increasing the economic strength and staying power of the masses include a great variety of measures more easily suggested than carried out, such as raising the credit of the cultivator and his standard of living; construction of direct and indirect protective works like irrigation canals, roads, and repairing wells; improvement in general administration—more especially land revenue administration with a reasonably light assessment and a sympathetically administered system of suspensions and remissions; a well thought out and liberal forest policy; improvement of agriculture through the agency of the agricultural department, agricultural colleges, research institutes, etc.; the fullest utilization of the co-operative movement; development of large-scale industries and encouragement to cottage industries—in short, economic planning for the country in all its aspects.

Middle Class Unemployment

§11. **The scope of the problem.**—The terms 'educated' and middle class' are in common use, but it is not easy to draw precise dividing lines between the educated and the uneducated, or between the middle class and the higher and lower classes. It is usual to include in the term 'educated middle class' such persons as are not well-to-do enough to dispense with earning their own living, who follow non-manual occupations and have received some form of secondary or higher education. Sometimes, however, those who have at least completed the full vernacular or anglo-vernacular course are also regarded as coming within the definition of the 'educated class'.

§12. **The seriousness and extent of middle class unemployment.**—Middle class unemployment has in recent years assumed alarming dimensions and attracted widespread public attention, and Central and Provincial Legislatures, as well as semi-official bodies like the Universities have of late interested themselves in this

problem.[1] Between 1924 and 1928 a series of investigations through specially appointed committees were carried out in some of the British Indian Provinces (Bengal, Madras, Bombay and the Punjab) and also in some of the Indian States like Travancore. The most recent committees were those appointed by the United Provinces Government (1935, under the chairmanship of Sir Tej Bahadur Sapru), and by the Bihar Government (1937).[2]

The Reports of all these committees leave no doubt regarding the all-India character of the problem of unemployment among the middle classes.[3] The Madras Committee point out that the proportion of educated men seeking employment to the demand for them is roughly two to one, and as the result of certain calculations about the annual output of schools and colleges and the proportion of vacancies occurring in the natural course of things, they conclude that the amount of unemployment is very distressing. The Punjab Committee (1927) after similar calculations found that, whereas the output of anglo-vernacular schools and colleges had more than doubled during the five years 1922-7, there had been nothing like a corresponding increase in the number of posts available in the Government Departments or in commercial and business firms. While the total number of applications received for a post which is advertised is by no means an accurate index of the extent of unemployment, for some of the applicants may be in possession of jobs and may yet desire to improve their prospects, it is nevertheless significant that two test advertisements in the Madras Presidency given at the instance of the Madras Committee called forth 666 and 787 applications respectively. The first was a clerk's post in the P.W.D. carrying a salary of Rs. 35 per mensem, and the second was a clerk's post in a commercial firm on the same pay.

Unemployment on this scale is a more serious evil than is commonly recognized. Besides the individual suffering it causes to the unemployed, their disappointment and sense of injury produce a general demoralization which is cumulative in its effect from generation to generation. The existence of a large number of disgruntled young men is also dangerous to the political

[1] The Conference of Indian Universities held in 1930 considered the question, but had nothing more to suggest than that Universities should collect statistics regarding unemployment among their products.

[2] The Bombay Labour Office is at present (1938) engaged in carrying out a fresh inquiry into unemployment among university graduates.

[3] An interesting review of the situation regarding middle class unemployment in the different Provinces and Indian States and of the measures of relief, either adopted or contemplated, will be found in *Proceedings of the Ninth Industries Conference* (1937), Bulletins of Indian Industries and Labour, No. 65.

stability of the State. The point has been well put by the Sadler Commission: 'The existence and the steady increase of a sort of intellectual proletariat, not without reasonable grievances, forms a menace to good government especially in a country where . . . the small educated class is alone vocal. It must be an equal menace whatever form the government may assume. So long as the great mass of the nation's intelligent manhood is driven, in ever-increasing numbers, along the same, often unfruitful, course of study, which creates expectations that cannot be fulfilled, and actually unfits those who pursue it from undertaking many useful occupations necessary for the welfare of the country, any Government, however it may be constituted, whether it be bureaucratic or popular, must find its work hampered by an unceasing stream of criticism and a natural demand for relief which cannot possibly be met.' Again, the gospel of revolutionary socialism or communism finds willing devotees in young men who nurse a strong sense of personal injury against a scheme of things in which apparently they have no place.

§13. **Classes particularly affected.**—The Bombay Enquiry finds that numerically the most important section affected consists of young persons below 27 years of age, especially those whose training has been purely literary and who have proceeded to higher education through the anglo-vernacular course. As might be expected, unemployment is most acute among those who have not succeeded in passing the School-Leaving or Matriculation examination which is considered to be the minimum qualification for Government service, less so among matriculates and intermediates, and (comparatively) least of all among graduates with professional qualifications. In the teaching profession there is more unemployment among untrained than among trained teachers. As regards the legal profession, it is commonly agreed that it is much overstocked, and many junior members of the bar find it difficult to make a living. Similarly, the medical profession is overcrowded in the larger towns, though there is a paucity of medical men in the villages and smaller towns, where the amenities of life are poor and the people not accustomed to pay regular cash fees for medical relief. The position of engineers is only slightly better. There are large numbers of persons who are fit and willing to be employed on the railways, but are not yet trained, and therefore fail to get employment. As regards banking and accountancy, while those who have received advanced special training or acquired experience do not remain without jobs, there are scores of others who have had no special training and who fail to get employment.

§14. **Causes of unemployment.**[1]—(i) *Post-War economic depression and retrenchment.*—India, like the rest of the world, has been affected by the post-War economic depression. Large numbers of persons employed in the clerical and the combatant branches of the army were discharged on the cessation of the War and it has not been possible to absorb them elsewhere, as even the normal volume of employment offered by Government and semi-public bodies and business firms has not been available. The axe of retrenchment has been applied in all directions and even the old establishments have not been fully maintained. The economic depression became particularly severe during the years 1929-34 and the middle classes along with others passed through a period of unexampled distress. A limited recovery has taken place since then.

(ii) *Defects of the educational system.*—Another alleged cause of unemployment is the lack of adjustment between the system of education now in force in the country and the needs of industrial progress. The opinion is widely held that our present system of education is such as to produce persons qualified almost exclusively for clerical occupations, and that it is regarded almost as an avenue to Government service.[2] Sir George Anderson, in his note prepared for the Punjab Committee, admits that 'in its very inception, it (the present system of education) was moulded with the special object of preparing boys for external examinations, the passing of which is for many only a snare and a delusion, and with the object of training boys for clerical vocations which are now proclaimed to be overstocked and which offer insufficient avenues of employment to large throngs of applicants', and he proceeds to describe the matriculate, whom he regards as the crux of the problem of unemployment, as 'a derelict, a wanderer on the face of the earth, unemployed because he is unemployable'.[3] The

[1] The Bengal Committee suggest a classification of unemployment based on a distinction between a man who is unemployed through no fault of his own and another man who is unemployed because he is really unemployable in the type of available employment he seeks, frequently through causes over which he has no control. See *Report of the Bengal Unemployment Committee*, par. 2.

[2] 'Our high schools and colleges suffer not for want of vocational training but for their concentration on training of a definitely vocational but very limited type. Essentially practical and utilitarian, they have aimed at the production of Government officials, lawyers, doctors, and commercial clerks.'—A. Mayhew, *The Education of India*, p. 149.

[3] As the Bengal Committee observe, one great defect of the educational system is that it leads to one end only, namely, the M.A., M.Sc., or B.L. examination. 'It is like a *bamboo*, each joint being an examination and the diameter remaining practically the same size from the root to very near the top.

average educated Indian looks first to Government service as a means of livelihood and, failing that, to clerical work under some semi-official body, such as railways, municipal and other local bodies, port trusts and the like. A further charge made against the educational system is that it renders boys unfit for their ancestral occupation, as they cannot for a minute picture themselves stooping so low as to earn their living with their hands, and prefer being fifth-rate clerks after a smattering of education to earning a better income in the so-called manual occupations, including agriculture. The ranks of those who have traditional aversion to manual labour are thus swelled by the present system of education[1] which is 'sterilizing' and tends to 'diminish the intellectual energy of those who receive it and is in many cases a positive disadvantage to them'.[2] The agricultural, artisan and backward classes themselves are trying more and more to send their children to schools and colleges with a view to Government service and the learned professions and thus promote themselves to the higher rungs of the social ladder. This fatal fascination exercised by literary and quasi-literary occupations, within whose range of influence even the classes who have had no tradition of 'letters' are being increasingly drawn, further emphasizes the prevailing unemployment among the educated classes. We must, however, add that while it is true enough that parents do not display the necessary vision and foresight in choosing occupations for their boys, this may to a certain extent be attributed to the absence of suitable and adequate facilities for practical education—agricultural, technical, industrial or commercial.

(iii) *Social causes.*—There are also certain social causes such as the caste system, early marriage, the joint family system and communal inequalities, all of which 'operate powerfully though silently in determining as well as impeding the economic ambitions and fortunes of the educated men'.[3] For instance, caste fiat prevents educated men from taking to useful occupations which are regarded as undignified in the particular communities to which they belong. Early marriage not only interferes with adequate training

It has no branches and the crowning top covers a very small area. What is required is a spreading tree with branches going off in as many directions as possible at definite points along the trunk, not all at the top.'—See *Report of the Bengal Unemployment Committee*, par. 29.

[1] This is indicated by the large proportion of the educated unemployed in Madras being sons of cultivators, as revealed by certain figures collected in connexion with the census of 1931.

[2] Sir Philip Hartog's evidence before the Bengal Committee.

[3] *Madras Report*, p. 18; see also vol. I, ch. iv.

but also places too early in life the responsibility of maintaining a family on the shoulders of young men. The joint family system, while it makes the burden of this responsibility lighter and offers protection to the weak and the helpless,[1] leads to economic parasitism and cramps individual initiative and ambition. Unwillingness to move out of their abodes and seek their fortunes away from their homes, which is one of the results of the joint family system, is another suggested cause of unemployment among the educated classes. On the other hand, according to the Madras Committee on middle class unemployment, this immobility is on the decrease and has little bearing on the bulk of unemployment, which is mainly the result of the supply of men being far in excess of the demand for them.[2]

(iv) *Economic backwardness.*—The most important cause of middle class unemployment is the very poor industrial development of the country and the paucity of openings available for educated young men. In England there are altogether about 16,000 occupations excluding the army, navy and the civil services. In India there are perhaps less than 40.[3] The mere extension of the facilities for vocational and technical training, it must be remembered, does not fully meet the situation. It will no doubt speed up the development of industries but it will not by itself call them into existence unless special measures are adopted simultaneously for the promotion of industries to absorb the trained men. As the Bengal Committee (*Report*, par. 30) wisely remark, ' In an ideally balanced development technical training and economic progress should proceed forward together, each being stimulated in turn by the other. When one lags it should receive a stimulus and vice versa '. In the usual discussions about the causes of unemployment, sometimes exaggerated emphasis is placed on the excessively literary character of the present system of education in this country and on the presence of caste prejudices, to the neglect of other factors such as the under-development of the economic resources of India. This, as has been repeatedly pointed out, is at the basis of the poverty of the masses and, in the last analysis, dominates all species of unemployment.

[1] The *Bombay Report* shows that 49·46 per cent of the total, or nearly half the unemployed persons in the Presidency, were supported by their relatives during the period of unemployment, 8·15 per cent maintained themselves on previous savings, 7·67 per cent by casual work, 4·91 per cent by income from real property. Cases in which the unemployed had to depend upon vicarious charity were comparatively few. See op. cit., par. 94.

[2] *Madras Report*, pp. 18 and 27.

[3] See *Travancore Report*, par. 58.

§15. **Remedies for unemployment.**—*Employment Bureaux.*—The causes of unemployment being many and various, there can be no one sovereign remedy for it. In the first place, certain palliatives which have been put forward may be noticed. Employment bureaux run by universities, Government departments or private agency, have been suggested. Employment Boards have been established in the United Provinces and the Punjab, for bringing together employers and the unemployed (see §18 below). These would undoubtedly serve a useful purpose, if efficiently managed, so as to secure public confidence. We must, however, remember that they can at the most bring about a better adjustment between supply and demand, especially in the case of private business firms where people employed are not usually of sufficient qualifications. They cannot provide any corrective to the growing excess of supply of men in relation to the demand for them.

Migration or emigration has also been proposed as an antidote to unemployment, but since middle class unemployment is an all-India problem, migration within the country can hardly be regarded as a solution. It can only equalize the intensity of the problem in all parts of the country. As regards emigration, we have already argued elsewhere that, in the existing circumstances, not much relief can be expected from it.[1]

§16. **Statistical survey of unemployment.**—The Government of India, in a circular issued to the Provincial Governments in May 1937, have urged the collection of comprehensive statistical material as the first step towards the adoption of remedial measures dealing with middle class unemployment. The most hopeful line, it is pointed out, is to collect statistics of employment rather than unemployment, and in order to secure reliable statistics the Government of India consider that legislation is necessary. Such legislation should be central in order to ensure uniformity, and the Government of India are prepared to promote it, provided the several Provincial Governments are ready to support the proposal. In the first instance it would probably be desirable to restrict the inquiry to an organized industry, that is, regulated factories, mines, railways. Investigations may thereafter be extended to various commercial occupations and possibly less organized forms of employment. Such a survey would furnish a basis for estimating the needs of the various industries and commercial concerns for qualified men with different types of technical qualifications with a view to better correlation of supply and demand. Such statistics would also make it possible to form a general estimate of the

[1] See vol. I, ch. iii, §§31 and 38.

potentialities of the absorption offered by industry and commerce for educated young men, whether their qualifications are technical or general, and thus to reach a position where the probable effects of different possible policies on unemployment can be gauged. Lastly, the statistics would help to meet the public need and demand for statistical material and would enable the subject to be viewed in the light of facts rather than conjectures. We strongly support this well-reasoned plea for an all-India survey of employment in India.

§17. **Other remedies.**—As stated above, unemployment of all grades and shades is in the final analysis the reflex action of economic backwardness, and everything that leads to the economic betterment of the country will obviously be a remedy for unemployment.[1] Material advance will not only create fresh avenues of employment for the middle class, but, by raising the general level of prosperity attained by the community, will increase the demand for the services of lawyers, doctors, teachers, etc. Further, with the increase in general prosperity coupled with the progressive Indianization of the superior civil and military services, the scope for employment in the administrative services will expand; and, lastly, we may add that any comprehensive programme launched by the Government for bringing about the regeneration of the country will itself absorb immediately a certain number of the educated unemployed.

The Madras Committee declare that 'the principal remedy (at any rate so far as Madras is concerned) for the present unemployment should be the diversion of the educated middle class, especially those who own or occupy land, to agriculture', and to facilitate this diversion, the Committee desire that 'somehow or other the idea that the agriculturist is socially inferior to the clerk or lawyer, or the teacher, must be uprooted'.[2] The Bihar Unemployment Enquiry Committee in their Report (November 1937) express a similar view and hold that the question of diverting some educated young men to agriculture or, at least, preventing their migration to towns is very important for an essentially agricultural province like Bihar. We have already had occasion to comment

[1] cf. 'The true remedy for unemployment amongst the middle classes, as indeed among other classes, is the rapid development of the resources of the country.'—*Proceedings of the Fifth Industries Conference* (1933), p. 124.

[2] *Madras Report*, p. 25. The Bengal Committee also make a similar suggestion and recommend the amendment of the Agricultural Loans and Land Improvement Act so as to assist the *bhadralok* class in Bengal. See *Report of the Bengal Unemployment Committee*, par. 47.

on the tendency towards absentee landlordism and the drift of the educated classes from the villages to the towns. These evils must be checked and the middle classes induced to apply their brains to agriculture and help themselves and the country. There are already signs that the prejudice against agriculture and other manual occupations is disappearing under the sheer weight of economic necessity.

The proposal of the Madras Committee to establish 'farm colonies' is of considerable interest, but has its practical limitations. In the first place, barring provinces like the Punjab and Assam, there is not much good cultivable land available to grant to the educated unemployed, even if the superior claims of the village community and the depressed classes were to be ignored. Secondly, as the Madras Committee themselves admit, the temptation for middle class parents to send their children to schools and colleges with a view to Government service would increase if it became generally known that the Government would find land for the unemployed educated young men.

The majority of the Punjab Unemployment Committee suggest that one way of relieving unemployment is to provide facilities for higher education only for the markedly able, who, if poor, should be subsidized by the State, or for those who can pay its full cost (par. 19). We do not think that anything should be done deliberately to increase the cost of education or to limit the scope for higher education in the country, though we admit the necessity of somehow making parents realize that the present supply of men far exceeds the demand in Government service and the legal profession, and that it is necessary for them to think of other careers for their children. The Sapru Committee are also against artificially restricting admission of students to the universities. There is more point in the suggestion of the Travancore Committee that the question of recruitment to all grades of Government service by means of competitive examinations should be seriously considered. Definite competitive tests and a stiffening of standards will weed out a large number of candidates and prevent the useless 'dissipation of energy involved in running about to secure recommendations or to cultivate patronage'. Those who fail in the competition will know that Government service is out of the question for them and this will impel them to do something else instead of hanging about indefinitely on the mere off-chance of obtaining an appointment some time. This will also raise educational standards and enable the services to get better recruits. We have already suggested that even if we admit the principle of communal representation in the services, it should be tempered

by competitive recruitment. The subject of the reform of the educational system itself has already been discussed.[1]

Lastly, it must be noted that side by side with the improvement of the educational system[2] there must also be a radical change in the social system and in the general outlook of the people. All obsolete ideas and practices which hamper economic (and political) progress must be fearlessly denounced, and sustained and strenuous efforts must be made to destroy them. For, as the Sadler Commission remark: 'The education of a people is not given by schools and colleges alone. Other influences blend with theirs, the spirit and temper of the community which they serve, the power exerted over its thoughts and character by prevalent aspirations and beliefs, the tone of its family life, the rules and restraints imposed by its social organization, the conditions under which its daily work for livelihood is done.'

§18. **The Sapru (Unemployment) Committee.**—We may here refer to some of the more important recommendations of the Sapru Committee on unemployment in the United Provinces as they have an obvious bearing on the unemployment situation in other provinces, and classify them as follows: (i) those which aim at increasing the demand for educated men; (ii) those which aim at avoiding excess of supply; and (iii) those which aim at a proper adjustment of supply to demand (actual or potential).

(i) Municipalities and District Boards should be compelled to employ qualified engineers and supervisors for the purpose of maintaining roads and buildings in an efficient condition.

The Government might with benefit provide more employment for qualified medical men by extending the scope of public medical relief, by attaching more private practitioners to public hospitals, by starting investigations conducted through qualified medical men into the efficacy of indigenous drugs, etc.

Municipalities and District Local Boards should be compelled to employ properly qualified medical officers for carrying out their duties in connexion with public health and sanitation.

The overcrowding of the legal profession may be remedied to some extent by the introduction of greater specialization of

[1] See vol. I, ch. viii, §2; and vol. II, ch. i, §§13-14. See also *Report on Vocational Education in India*, by A. Abbot and S. H. Wood (1937).

[2] The Government of Bengal have sanctioned a scheme which is calculated to provide vocational training in a number of small industries (such as manufacture of umbrellas, brass and bell-metal articles, cutlery goods, glazed pottery, washing soap, jute and woollen articles of common use) to the youths belonging to the *bhadralok* (middle) class. *Proceedings of the Fifth Industries Conference* (1933), pp. 123-4. See also the Bombay Government's scheme of Trade Apprenticeship (1937).

functions, e.g. some should specialize in drafting documents, others in arguing cases, etc.

The Government should consider the question of restoring, as finances permit, useful posts which have recently been retrenched on grounds of economy.

The rules regarding retirement of public servants at the age of 55 should be strictly enforced so as to give a chance of employment to new young recruits.

Large-scale and small-scale industries should be stimulated so that they might absorb an increasing number of our young men.

Vigorous steps should be taken to introduce compulsory primary education, without which no substantial economic progress is possible. This would also mean an increased demand for teachers, and would so far remedy the existing unemployment.

(ii) The High School examination should have two kinds of certificates—one certifying completion of the course of secondary education and qualifying for the subordinate branches of Government service and also for admission to industrial, commercial and agricultural schools, and the other qualifying for admission to Arts and Science colleges. In this manner many students who are really unfit for a university career in Arts and Science will be diverted at the close of their secondary education, and this will reduce the number of unemployable graduates.

(iii) The facilities for practical training in the various technical educational institutions should be extended, and education in general should receive a more pronouncedly practical and, in the case of primary schools, a definitely rural, bias.

Medical practitioners should be encouraged, if necessary with the help of generous subsidies, to settle down in rural areas instead of congregating in the few big towns.

Steps should be taken to develop new professions like pharmacy, dentistry, accountancy, architecture, librarianship, insurance work, and journalism, and suitable training should be provided for qualifying for these careers.

An attempt should be made to induce agricultural graduates and diploma holders to make scientific farming a means of livelihood. The development of dairy farming would afford another possible avenue of employment for them.

Steps should be taken to bring qualified educated men into touch with commercial houses for employment. Regional vocational guidance authorities should be created for this purpose.

The Government should spread broadcast information regarding possible careers and bring into existence suitable machinery for

giving sound advice to parents regarding the aptitudes of their boys and the choice of a suitable career for them.

Secondary schools should provide much more diversified courses of study than at present, and in the universities greater stress should be laid on scientific and vocational education.

An Appointments Board, more or less modelled on the Appointments Board at Cambridge, should be created for university graduates. It should consist of the Vice-Chancellors of the universities, certain heads of departments (e.g. Education, Industries and Agriculture) and some public men and European and Indian business men. Similarly a Board should be created to deal with the products of the secondary schools, medical and agricultural schools, and industrial schools. These Boards should be required to collect statistics of employment among graduates of universities and products of the secondary schools and intermediate colleges.

The Government of the United Provinces have recently (October 1936) announced measures to implement the Sapru Committee's recommendations. These include (i) provision for practical training in industry and agriculture under almost commercial conditions, (ii) state aid in the establishment and running of an industrial credit company and a company for marketing and small-scale finance; (iii) subsidies to rural medical practitioners; (iv) establishment of centres of agricultural improvement; and (v) a Provincial Employment Board composed of representatives of various interests. Additional taxation of Rs. 4 lakhs annually has been voted by the U.P. Legislative Council for expenditure on these measures of unemployment relief.

CHAPTER XIII

OTTAWA AND OTHER TRADE AGREEMENTS

§ 1. **Imperial preference.**—Before embarking on a discussion of the Ottawa and other Trade Agreements it is proposed to give here a brief account of the genesis, nature, objects and limitations of imperial preference with special reference to conditions in India.[1]

There was a time when an influential section of public opinion in England regarded the overseas possessions as an extravagance for the mother country and injurious to the colonies themselves. The day of the 'Little Englanders' is, however, long past, and England now desires to draw the bonds of imperial connexion closer together. The Colonies on their part have been showing in an increasing measure their appreciation of the material, moral and political benefits of inclusion within the Empire and may be said to have taken the initiative in granting certain concessions to British goods, placing them in a favourable position relatively to the goods of other countries. Advocates of imperial preference believe that it will not only lead to a large intertwining of economic interests among the Empire countries, but also teach the Empire to take effective concerted action in dealing with the outside world.

It is well to recognize clearly certain important provisos to which all proposals in favour of imperial preference are generally taken to be subject. (i) The adoption of imperial preference should not involve any relaxation or modification of the policy of protection which any of the States may have introduced to foster its industries. India having now gained the right of protecting herself even against the United Kingdom, imperial preference would mean in practice higher duties on imports from foreign countries than on those from the Empire countries.[2] (ii) The concessions granted to the Empire countries are to be *purely voluntary* on the part of the country granting them and not dictated either by the mother country or by binding resolutions passed at periodical Imperial Conferences. (iii) Lastly, the view is strongly held, especially in India, that no scheme of imperial preference should be such as to provoke international ill-will or to exclude the possibility of a closer economic unity and of friendly understandings with foreign countries.

[1] For a detailed treatment of the subject see *Fiscal Commission Report*, ch. xiii.

[2] Before the War of 1914-18, Imperial Preference was favoured by some as the next best alternative to pure protection, which then seemed unattainable. See Sir Roger Lethbridge, *The Indian Offer of Imperial Preference*, p. 8.

§2. **History of the movement.**—The movement towards Empire trade consolidation may be said to have made a start in 1897, when Canada lowered her duties by one-eighth in favour of British goods. In 1898, the preference, fixed at one-fourth of the duty, was given to the United Kingdom unconditionally, but so far as the other Colonies were concerned, it was made conditional on favourable treatment granted by them to Canada. The Colonial Conference which met in 1902 adumbrated the policy of imperial preference as one of general application to all parts of the Empire, which were invited to fall into line with Canada. Accordingly, preferential duties in favour of Great Britain were introduced by New Zealand and South Africa (1903) and later by Australia (1907), and the United Kingdom was expected to reciprocate and grant preferences in return. England, however, was not then prepared to depart from her free trade policy. She mostly imported raw materials and food-stuffs, and her attitude was that her interests as a great exporter of manufactured articles demanded that she should obtain the food-stuffs and raw materials in the cheapest market. Especially in the matter of food-stuffs she was not perpared 'to put all her eggs into one Imperial basket'. In the circumstances, the United Kingdom was unable to take any part in the general movement for imperial preference. The self-governing Colonies, however, continued the policy they had begun, hoping that the mother country would find ways of joining in at some future date. Since 1920 the Dominions and Colonies have given extensive preferences to the United Kingdom, and by 1922, preferential tariffs were in operation in twenty-six British Colonies. Their tariffs thus came to consist of (i) revenue duties, (ii) protective duties and (iii) certain remissions of duty in respect of (i) and (ii) in favour of the United Kingdom, and in some cases also in favour of India and other Empire countries. There was also a limited free list of commodities taxed only when they came from outside the Empire. As a general rule preferences granted by the Dominions have primarily sought to benefit the United Kingdom, and they have been left to be extended to other parts of the Empire by special negotiations in each case. The approaches which England had made since 1915 towards protection enabled her to grant preferential reduction of duties on a limited number of articles of Empire origin. Great Britain's formal renunciation of a free trade in favour of a protectionist regime with the enactment of the Import Duties Act in March 1932 is an event of first-rate importance from the point of view of imperial preference.

§3. **Preference and protection compared.**—In essence preference is a form of protection granted to the favoured country. The only

important difference is that, under protection, the consumer's interests are sacrificed for the direct benefit of some industry in his own country, whereas under preference the benefit of the sacrifice goes to the producers in the country favoured.

Like protection, preference, besides imposing a burden on the consumer, may also involve a sacrifice of Government revenue even when it takes the form of raising existing duties against foreign goods while continuing to apply the old rate to the goods of the preferred country; for if prices are regulated by the higher rate, the difference between the higher and lower rate goes into the pockets of the favoured producers. The whole amount of the duty paid by the consumer does not find its way into the Government treasury.

Apart from its uses as an aid to the full development of Empire resources, imperial preference is also advocated as tending to make the Empire self-sufficient, just as national self-sufficiency is put forward as one of the aims of protection. As a closed economic system, however, the Empire would be a highly artificial organization and would impose unduly heavy sacrifices on some of its constituent members like India. Considering her economic position, India stands to gain by the freest possible development of her economic relations with a number of countries which happen to be outside the Empire. Imperial self-sufficiency again will not be of any appreciable benefit from the point of view of military safety, nor would it reduce the cost of defence. England glories in her far-flung Empire, but its far-flung character makes the maintenance of one of the biggest navies in the world a matter of vital importance whether for warding off an attack on her possessions or transporting essential goods from one part of the Empire to another.

§4. **Indian attitude towards imperial preference.**—As a member of the British Commonwealth, it might be urged, India ought to be interested in imperial preference in so far as its object is to increase the strength and solidarity of the Empire. She is, however, less fortunately situated in this respect than the self-governing Dominions. The Dominions having received the gift of self-government from the mother country are bound to her by ties of gratitude. As between themselves also their relations are cordial and not marred by any sense of grievance or injustice between Dominion and Dominion. It must be frankly admitted that India's position is different. She feels that in her attempt to realize her political and economic aspirations, she has often been thwarted and depressed by England, and the anti-Indian legislation enforced by the Colonies against her has naturally embittered her feelings against them. And human nature being what it is, her will to promote the cause

of imperial preference is bound to be largely paralyzed so long as she remains politically discontented; while to induce the Colonies to withdraw or substantially mitigate their anti-Asiatic legislation is patently a task of the greatest difficulty.

§5. **Economics of imperial preference in relation to India.**—Assuming, however, that India is anxious to do her best for imperial preference, the next question is how far it will be within her power to help England and the other members of the Empire by preferences and what direct economic benefits are likely to accrue to herself by preferences granted to her. In this connexion it will be necessary to examine briefly the position as regards India's export and import trade as summarized in the subjoined table, which shows the percentage share of the British Empire and the United Kingdom in the import and export trade in merchandise only.[1]

Countries	Pre-War Average		War Average		Post-War Average		1931-2		1933-4		1934-5		1935-6		1936-7	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
British Empire	69·7	41·1	65·4	51·7	65·2	41·4	44·8	44·5	50·0	46·7	49·4	45·9	48·7	46·4	49·2	46·3
United Kingdom	62·8	25·1	56·5	31·1	57·6	24·2	35·5	28·2	41·7	32·2	40·6	31·6	38·8	31·5	38·4	32·1

The following main facts must be borne in mind as being relevant to the question at issue:

(i) India's imports consist largely of manufactured articles and her exports of raw materials and food-stuffs. (ii) In the pre-War period about two-thirds of her total imports came from the British Empire, the United Kingdom contributing by far the largest share to the imports from the British Empire. (iii) Before the War, Indian exports went preponderantly to foreign countries, only about forty per cent of the total exports being absorbed by the British Empire. The exports to the United Kingdom amounted to about one-fourth of the total exports. (iv) During the post-War period, as the above table shows, there has been a tendency towards a gradual relative decline of the importance of the United Kingdom and the British Empire in the trade of India both as regards exports and imports, but specially as regards imports. Between 1932-3 and 1933-4 there was an improvement in the position of Great Britain, her share in imports having risen to 41·7 per cent from

[1] *Review of the Trade of India, 1936-7,* p. 201.

35·5 per cent in 1931-2. This recovery has been largely attributed to Great Britain's favourable position in the Indian market under the Ottawa Preferences.[1] In recent years, however, the percentage share of the United Kingdom has been on the decline, being 38·4 in 1936-7. Her share in the export trade has, however, considerably improved, with the result that the usual excess of merchandise imports over exports in the case of our trade with the United Kingdom was transformed in the year 1936-7 into a favourable balance of Rs. 13 crores.

With regard to the artificial stimulation of imports from the United Kingdom and other Empire countries, we must not forget that India is a poor country, and the protectionist policy on which she has embarked will require on the part of her population various kinds of sacrifice. The capacity of the country to bear further burdens on the score of imperial preference is strictly limited, and the actual concessions she may be in a position to grant are likely to appear insignificant.

In 1903 the Government of India expressed the view that 'from an economic standpoint India has something, but not perhaps very much, to offer to the Empire, that she has very little to gain in return, and that she has a great deal to lose or to risk'.[2] They feared that preference shown by India to Empire countries would be met by retaliatory measures against her on the part of foreign countries. No doubt the tendency at the present time is to regard inter-Imperial trade arrangements as strictly matters of domestic concern, and not as hostile acts aimed at foreign countries. However, whether we can safely regard the danger of retaliation as negligible will depend upon the spirit inspiring any particular action taken in furtherance of the policy of imperial preference, and the extent to which foreign nations are adversely affected by it. Her foreign markets are much too important for India to be lost or endangered through any ill-judged policy of imperial preference.

As imperial preference implies co-operation of free peoples and not dictation by any outside authority, it follows that all proposals towards imperial preference must receive the sanction of the Indian Legislature before being put into force. How far the Legislature will be allowed to exercise a decisive influence in shaping the tariff policy of the country under the new constitution remains to be seen. Everything, of course, depends on the manner in which the safeguards and the provisions in respect of discrimination[3] are interpreted.

[1] This subject has been discussed in greater detail in ch. vi, §14.

[2] This view was repeated by India's representatives at the Imperial Economic Conference of 1923.

[3] See vol. I, ch. xiii, §19.

§6. **The Ottawa Agreement.**[1]—The Imperial Conference which met in London in October 1930 discussed the question of imperial preference and other methods that were suggested, such as the Quota System, Bulk Purchase, etc., by which the Empire countries could utilize one another more and more effectively for mutual advantage. No tangible result was, however, achieved by the Conference beyond a mutual assurance on the part of the members of the Empire regarding the continuance of existing preferences for a period of three years. Sir Geoffrey Corbett, the Indian delegate, stated that while India was ready to consider favourably all schemes designed to encourage the development of inter-imperial trade she was unable to commit herself to any general scheme of preference, and that she was not prepared to depart from her policy of discriminate protection. At the Imperial Economic Conference held at Ottawa during July-August 1932, however, a Trade Agreement was concluded, and India found herself participating in just such a scheme of extensive imperial preferences to which she had all along shown a strong antipathy. We have already[2] reviewed the Indian Tariff (Ottawa Trade Agreement) Amendment Act of 1932 (December) which gave effect to the tariff changes necessitated by the general trade agreement made between the Government of India and His Majesty's Government in the United Kingdom on 20 August 1932. The tariff changes so effected came into force from 1 January 1933. A supplementary agreement regarding iron and steel was signed on 22 September. Both the agreements were ratified by the Indian Legislative Assembly. The Ottawa Trade Agreement could be terminated at any time after six months' notice of denunciation by either party. We propose here to state briefly the case for and against Ottawa, as this will give us an idea of the arguments and the passions behind the question of imperial preference as affecting India.

§7. **The case for Ottawa.**—The first phase of the recent economic crisis was characterized by a great decline in all prices, but a relatively heavier decline in the prices of raw materials. In consequence of this, India, along with other suppliers of raw materials, was particularly badly hit. In addition to this, her export

[1] See Press Notes issued by the Director of Public Information, *India and Ottawa* and *India's Foreign Trade Policy* (1936). The best statement of the case against Ottawa is to be found in D. R. Gadgil's *Imperial Preference for India* (Gokhale Institute of Politics and Economics, Publication No. 2), and the series of articles contributed by the same author to the *Servant of India* between 16 January 1936 and 12 March 1936. The reader is also referred to D. Ghosh, *Revision of Ottawa* (1936), and N. R. Sarkar, *Indo-British Trade Relations, Ottawa and After* (1937).

[2] See ch. xi, §5

trade was being subjected to growing competition in western markets. Virgin lands in many parts of the world—in Africa, South America, the Asiatic Archipelago, etc.—were being brought under cultivation, and their products began to be introduced to the world markets all the more easily because of the improved transport facilities.

In other countries also production was expanding, and foreign exporters who before the War were comparatively insignificant were now proving serious competitors: the force of the increased competition was keenly felt by some of our main exports like oil-seeds, textile fibres, food-grains, timber, etc. The position was further made difficult by the policy adopted by many of the European countries and the United States of America of stimulating the demand for the products of their own colonies in the tropical and sub-tropical regions. Another factor of ominous significance for countries like India was the rapid development of synthetic substitutes, which tended to reduce the demand for some of India's staples of export. Many countries, again, had embarked on a policy of economic isolationism which led to the erection of higher tariff walls, the imposition of 'contingents' and quotas, the institution of stringent foreign exchange controls and other restrictions on the free flow of international trade.

In the meanwhile (September 1931) Great Britain had abandoned the gold standard, and the currencies of India and of most of the other Empire countries were linked to sterling. By the Import Duties Act of 1932, referred to above, duties had been imposed in Great Britain on a wide range of articles covering nearly two-thirds of the total imports. Provision was, however, made for the exemption of Empire products from these duties, pending negotiations with the Dominions and India for the conclusion of reciprocal tariff arrangements—negotiations which eventually issued in the Ottawa Agreement. In the opinion of its advocates, it was a wise step on the part of India to have entered into the Agreement, for failure to do so would have meant forfeiture of her access to the world's most stable and largest open market, namely the United Kingdom. As explained above, the normal outlets for India's exports were shrinking fast. Other countries like France and Germany were still struggling with currency difficulties. The countries belonging to the sterling group were on the other hand comparatively free from these difficulties, and trade with them was for that reason likely to be smooth and unhampered by exchange embarrassments. For all these reasons it was argued that India had acted in her best interests by deciding to participate in the Ottawa arrangements.

Reviewing the main features of India's export trade three years later (in 1936), the friends of the Ottawa Agreement were able to prove, to their own satisfaction, that India had reaped substantial benefits from the Agreement and urged its continuance for a further period.

We give below some figures cited as relevant to the issue.

TOTAL EXPORTS FROM INDIA

(In lakhs of rupees)

Total value	1931-2	1932-3	1933-4	1934-5
To all countries	157,56	133,27	147,52	152,39
Index	100	84·6	93·6	96·7
To the United Kingdom	42,88	36,82	47,21	48,07
Index	100	85·9	110·1	112·1
To other countries	114,68	96,45	100,31	104,32
Index	100	84·1	87·5	90·9

—	Percentage increase in 1933-4 in comparison with 1932-3	Percentage increase in 1934-5 in comparison with 1933-4	Percentage increase in 1934-5 in comparison with 1932-3
All countries	10·5	3·3	14
United Kingdom	28·2	1·8	30·5
Other countries	4	3·9	8

EXPORTS FROM INDIA OF ARTICLES ENJOYING PREFERENCE

(In lakhs of rupees)

—	1931-2	1932-3	1933-4	1934-5
Total exports	110,93	95,04	99,34	94,41
Index	100	85·7	89·6	85·1
To the United Kingdom	33,30	29,73	36,48	36,71
Index	100	89·3	109·5	110·2
Percentage share of the United Kingdom in total exports	30·0	31·3	36·7	38·9
To other countries	77,63	65,31	62,86	57,70
Index	100	84·1	81·0	74·3
Percentage share of other countries in total exports	70·0	68·7	63·3	61·1

—	Percentage variation in 1933-4 in comparison with 1932-3	Percentage variation in 1934-5 in comparison with 1933-4	Percentage variation in 1934-5 in comparison with 1932-3
United Kingdom	+22·6	+ 0 6	+23·4
Other countries	− 3 7	− 8·3	− 11·7
Total . .	+ 4·5	− 5 0	− 0·7

(The total value of our export trade was Rs. 152·4 crores in 1934-5. The preferential items accounted for 62 per cent of it.)

Exports of coir manufactures, spices, castor seed and groundnuts from the Indian States enjoying preferences have been taken into account so far as statistics are available.

Exports from India of Articles Not Enjoying Preferences in the United Kingdom

(In lakhs of rupees)

—	1931-2	1932-3	1933-4	1934-5
Total exports	46,63	38,23	48,18	57,98
Index	100	82·0	103·3	124·3
Exports to the United Kingdom .	9,58	7,09	10,73	11,36
Index	100	74·0	112·0	118·6
Percentage share of the United Kingdom	20 5	18·5	22 3	19·6
Exports to other countries ...	37,05	31,14	37,45	46,62
Index	100	84·0	101·1	125·8
Percentage share of other countries .	79·5	81·5	77·7	80·4

—	Percentage increase in 1933-4 in comparison with 1932-3	Percentage increase in 1934-5 in comparison with 1933-4	Percentage increase in 1934-5 in comparison with 1932-3
United Kingdom	51·3	7·7	60·3
Other countries	20·4	24·4	49·7
Total ...	26·0	20·3	51·6

As seen from the above figures, between 1932-3 and 1933-4 India's export trade to the United Kingdom increased by 28·2 per cent, while her trade with other countries advanced by only 4 per cent.

The increased demand for raw materials was no doubt partly responsible for this improvement. But industrial recovery in the United Kingdom was by no means uniform over the whole range of production. The degree of recovery was greatest in the heavy industries, the raw materials for which are not supplied by India on any large scale. Therefore this factor could not be taken as accounting wholly for the increase in India's exports to the United Kingdom. Further, the import trade figures of the United Kingdom for 1932 and 1933 showed an increase in imports from India more than proportionate to the increase in the total imports of raw materials, pointing to the conclusion that the preferences must have contributed largely to the expansion in India's exports in 1933-4.

The figures for 1934-5 revealed a certain slowing-down in the rate of improvement. But this was only to be expected as the stimulus of a preferential duty would normally be felt most markedly in the first year and the rate of development would show a progressive decline until the limit of expansion was reached. Moreover, in the later years certain special factors supervened causing a definite check in the trade with the United Kingdom in certain commodities like tea (of which the exports were restricted in accordance with an international agreement), while other special factors at the same time operated to expand India's trade with other countries. For example, there were abnormal purchases of Indian cotton by Japan to make up for the short purchases during the 1933 boycott of Indian cotton in that country.[1]

The figures given above show that while the export of articles in the preferred group rose by about 10 per cent, the export of the non-preferred articles rose even higher, namely, by more than 18 per cent. This was interpreted by hostile critics as justifying the conclusion that the extension in the trade in the preferential items was due, not so much to the Agreement, as to the general increase in the demand for Indian goods in the United Kingdom caused by the revival of industrial activity, and further that in regard to the preferential items, the preferences granted by the United Kingdom were of little benefit to India.

This view, however, ignored several material facts. The *total* imports coming from all sources of the articles on the preferential list into the United Kingdom fell by about 22 per cent between 1931 and 1934. The imports from India thus increased in a market which was on the whole contracting, and therefore, it was legitimate to infer that the special factor of imperial preference must

[1] See §12 below.

have helped. The expansion in the non-preferential group was not surprising because this group comprised articles which had not to face any serious competition abroad and were for that reason not included in the preferential list. Again, in the case of some of the important items in the non-preferential group, there were certain quite specially favourable influences (apart from industrial revival) accounting for the increase in their off-take. Thus the increase in the demand for cotton was largely due to the propaganda of the Lancashire Indian Cotton Committee. The increase in rubber was due to the restriction scheme; that in metals and ores to the renewed activity in the heavy industries (as distinguished from *general* industrial revival); that in lac, to speculative purchases by the London 'ring', which tried to operate a corner in shellac and pepper, and so on.

The contention of the critics of the Agreement that the increased exports to the United Kingdom represented merely a diversion of trade was met by pointing out that while the increase of exports to the United Kingdom could fairly be attributed to the Ottawa preferences, the decline in the exports to foreign countries was due to the policy of self-sufficiency followed by these countries for reasons entirely unconnected with Ottawa. In fact, it was precisely this policy of restriction and the consequent loss of trade from which both India and England suffered, which formed the principal justification for Ottawa. It was no doubt true that India had hitherto been able to sell about two-thirds of her exports to countries outside the British Empire. But that she was finding it more and more difficult to retain her hold on these foreign markets was not her fault. The system of preferences was a measure of self-defence adopted by India. Some of its consequences, e.g. a decline in India's import trade with foreign countries followed by a corresponding diminution of her exports to them, were no doubt deplorable. But they were not of India's seeking and were in the circumstances inevitable. One of the arguments against the Ottawa Pact was that it would lead to retaliation against India by her foreign customers. But the various restrictions on import trade imposed by foreign countries were universal in character and not specially discriminatory against India. They were inspired by certain new ideals of trade policy, and there is no evidence to show that they were the result of irritation due to the Ottawa Agreement.

§8. **The case against Ottawa.**—Those who opposed the Ottawa Pact did so mainly on the ground that it tended to deflect India's trade from its natural channels and to give it a deliberate twist so as to inflict serious damage on it. If the preferences decreased

competition in the United Kingdom, they made it more severe in the other far more important foreign markets. An examination of the principal items of preference seemed to prove that only a few articles such as linseed, carpets, rugs and rice had derived any positive benefit from the preference. Since the separation of Burma from India from 1 April 1937, four important commodities which enjoyed preference under the Ottawa Agreement (viz. rice, teakwood, pig-lead, and paraffin wax), have dropped out of the possible scope of any fresh agreement with the United Kingdom.[1] In most other cases the vindication of the Ottawa arrangements was found to be either insufficient or wholly wanting. For some articles the preference granted was really not needed. For example, the tea trade was taking good care of itself through the Tea Restriction Scheme by which the main producers of tea, namely India, Ceylon and Java, had already come to an agreement amongst themselves. Even if India should lose some ground to Ceylon in the United Kingdom market, she might make that up by a corresponding gain in other markets under the scheme of fixation of total export quotas with reference to estimates of total world consumption. Preference, again, was unnecessary where the commodity in question already dominated the market in the United Kingdom, as in the case of jute manufactures, goat-skins, castor-seeds, lac, myrobalans and mica. In other cases the possibility of further expansion was slight for a variety of other reasons such as (i) the presence of other Empire competitors, e.g. Australia in tanned sheep-skins; British West Africa in groundnuts; Australia and Canada in pig-lead; Ceylon in coir-mats and spices; British East Africa in coffee. In some cases, the United Kingdom market was very small as compared to foreign markets, e.g. in groundnuts. Again, as regards certain articles, the total exports from India were too insignificant to make it worthwhile encouraging trade in them either by preference or otherwise, e.g. in rice, barley and tobacco.[2] Sometimes, the Indian commodity was not of the type wanted in the United Kingdom and hence could not benefit from the preference, e.g. Indian tobacco. Lastly, the effects of the preference might be largely cancelled by the competition of substitutes, as in the case of oil-seeds.

Another objection was that the preferences either caused a loss of revenue to the Government (i.e. in so far as trade was diverted from the higher to the lower duty) or to the consumer (i.e. in so

[1] Article by B. K. Madan, 'Bilateralism and Indian Trade', *Indian Journal of Economics*, July 1938.

[2] Sir Bryce Burt, however called the tobacco trade 'the valuable trade of £9,000,000' in an Assembly debate.

far as the consumer was compelled to buy comparatively expensive goods instead of cheaper non-British goods). Neither the Government nor the consumer in India was in a position to afford this sacrifice.

Imperial preference may suit the Colonies and Dominions whose trade with the United Kingdom is of a complementary character. England desires the primary products which the Dominions, especially Australia and Canada, have to offer, and, as it happens, they are able and willing to absorb a great many British manufactures. In both respects India's position is different. It is more advantageous and more feasible for her to find markets for her products elsewhere than in the United Kingdom, and her varied natural resources make it possible for her to think of self-sufficiency as a goal of her ambition, in fulfilment of which she desires protection against the competition of a number of British manufactured goods at present imported into India.

The post-War trend of India's foreign trade has been away from the Empire[1] and it is most important that she should make a systematic and determined endeavour to retain the foreign markets which absorb the greater part of her exports. Under present conditions the only method of achieving this is by entering into a series of bilateral agreements with foreign countries.[2] Ottawa, however, has sadly reduced India's capacity for bargaining by tying her hands in respect of far too large a number of commodities, so that she finds she has hardly anything to offer to foreign countries in return for any concessions she may seek from them. It is not likely that these bilateral agreements with other countries will seriously affect India's exports to the United Kingdom. Most of our exports to the United Kingdom are raw materials which British industry is interested in admitting free of duty. Moreover, England is our main creditor, and payment can only be effected through our surplus of exports over imports. Until recently this surplus arose in connexion with our trade with foreign countries; and even today the bulk of it thus arises. England must either take the necessary measures to enable us to retain our foreign markets or open her own market to us to make up for whatever loss we may suffer by the shrinking of the foreign markets. Otherwise it will be impossible for India to meet her obligations in England. The drift of the argument is that we need not fear retaliation on the part of the United Kingdom even if we refuse to participate in inter-Imperial arrangements on the Ottawa model. Also retaliation on the part of England would endanger her own

[1] See ch. vi, §13. [2] See §25 below.

considerable exports to India—worth more than Rs. 50 crores per year.

Much capital has recently been made by the supporters of the Ottawa agreement of the reversal of the balance of trade in recent years between India and the United Kingdom. Until 1935-6, India used to have a negative balance of trade with the United Kingdom in spite of the fact that this country has had to make large payments to England on account of 'invisible' imports such as the Home Charges, shipping freights, profits on foreign capital invested in India, etc. In 1936-7 there was actually an export surplus of Rs. 13 crores in India's favour. It has therefore been suggested that India should accord a generous treatment to the United Kingdom in any future trade arrangements. We may, however, point out that so far as it is proper to consider the trade balance on the narrow basis of bilateralism, we must add to the imports of merchandise from the United Kingdom, our ' invisible ' imports from that country. This is all the more necessary today since owing to the decline in triangular and multiangular trade, especially with European countries, we must have a larger export balance in merchandise with the United Kingdom. To some extent the operation of the Ottawa Agreement itself may be held responsible for this result, which therefore does not constitute a justification for liberal concessions to the United Kingdom. It has also been pointed out that a good portion of our exports to the United Kingdom is the product of British capital and enterprise in this country and the loss which might result from any restrictive action by the United Kingdom against India will adversely react on Great Britain herself.[1]

An important cause of dissatisfaction with Ottawa was the feeling that the Indian Delegation (which did not include any responsible representatives of Indian commerce, industry and agriculture) failed to make full use of India's bargaining strength vis-à-vis Great Britain and gave away too much and received too little in return. The agreement was too hastily devised and enforced and was not based on any thorough inquiry by a competent body such as the Tariff Board, which should have applied tests similar to those implied in the policy of discriminate protection before recommending any Empire industry to preferential treatment in India.

The controversy with regard to the effects of tariff arrangements such as those embodied in the Ottawa Agreement is difficult to set

[1] See article by Dr V. K. R. V. Rao, ' The Indo-British Trade Agreement ' *Indian Textile Journal* (April 1937).

out with precision. The course of international trade is governed by a variety of factors and it is impossible to assign definite consequences to any single factor or to attempt with any confidence a quantitative measurement of these consequences. In these circumstances, the only course to adopt is to state fairly the case on either side leaving the reader to form his own judgement on the question, and this is what we have tried to do above.

§9. **The Assembly's adverse verdict on the Ottawa Agreement.**—On 30 March 1936 the Indian Legislative Assembly turned down by a resolution the Ottawa Agreement and its sequel the Indo-British Trade Agreement (see §20 below) and voted against their continuance. The following is the text of Mr M. A. Jinnah's amendment to the official resolution carried by the Assembly.

'This Assembly recommends to the Governor-General-in-Council that the Ottawa Agreement dated August 20, 1932, be terminated without delay and notice of denunciation be given in terms of Article 14 thereof; the Assembly further recommends that the Government of India should immediately examine the trend of the trade of India with various other important countries and the United Kingdom and investigate the possibility of entering into such bilateral trade treaties with them, whenever and wherever possible, to bring about expansion of the export trade of India in those markets and submit such treaty or treaties for the approval of the Assembly.'[1]

The amendment was carried by 70 votes to 65. The Government of India being committed to abide by the decision of the Legislative Assembly, the six months' notice of termination of the Agreement was given on 13 May 1936 and the Agreement consequently was due to end on 13 November 1936. This period of notice afforded an opportunity of concluding a new agreement. Negotiations were set on foot between the British Government and the Government of India, who are being assisted by a panel of non-official advisers.[2] A Commerce Department *communiqué* dated 20 October 1936 stated that pending the conclusion of a new agreement the two Governments agreed that the 1932 Agreement should continue in force subject to termination at three months' notice by either party, unless it was replaced by a new Agreement. Also that in the event of failure to conclude a new Agreement

[1] See also §25.

[2] These are Sir Purshottamdas Thakurdas, Mr G. D. Birla, Mr Kasturbhai Lalbhai, Sardar Datar Singh, Nawabzada Liaquat Ali Khan, Dr P. Subbarayan and Sir Edward Benthall. Owing to the resignation of the last two members, the Raja of Parlakimedi and Professor W. Roberts were appointed as non-official advisers.

neither party should withdraw the existing preferences without prior consultation with the other party.

§10. **Protracted negotiations for a new Indo-British Trade Treaty.**—For the last two years and more protracted negotiations have been in progress between the Government of India and the British Government for the conclusion of a new trade treaty in place of the Ottawa Agreement of 1932, which still continues to operate in the absence of a new trade agreement between the two countries.

As it is not possible here to review in detail these negotiations, it is proposed briefly to indicate the principal stages.

The Indian non-official advisers met in September 1936 in order to examine the proposals sent by the British Board of Trade. The general impression was that the British trade proposals were pitched too high, and it was, therefore, decided to adjourn the Conference pending the receipt of revised proposals. Later in December (1936), when the non-official advisers met in Delhi, some fundamental principles were laid down for acceptance by the Government of the United Kingdom before proceeding with further negotiations. It is understood that these principles were acceptable to the British Government.

The Indian Delegation of non-official advisers and Sir M. Zafrullah Khan, Commerce Member to the Government of India, went to London in the latter part of the year 1937 and carried on negotiations with the representatives of the British Government, without, however, reaching any conclusions, and returned to India in October 1937. After a careful review of the position the Government of India decided that further progress should be sought along certain lines suggested by the non-official advisers. In January 1938 the Government of India deputed the Hon'ble Sir M. Zafrullah Khan to London to expedite the negotiations by personal discussions. He returned to India in April 1938 and held consultations with the non-official advisers in regard to the progress made in the settlement of major issues.[1] At this stage it was realized in England that the crux of the problem lay in a settlement with Lancashire. In May 1938 the British Board of Trade therefore sent a delegation representing the Lancashire textile industry to carry on further negotiations in India. As explained more fully in §19 below, these textile trade talks at Simla proved futile and the Lancashire Delegation had unsuccessfully to return to England. Thereafter the question was taken up by the two Governments. Sir M. Zafrullah Khan went a

[1] See M. P. Gandhi, *The Indian Cotton Textile Industry* (1938 Annual), p. 55.

third time to England in June 1938 and brought back with him the revised proposals of the Board of Trade, which recently (September 1938) were declared unacceptable by the Indian non-official advisers by a majority of five against two. Besides the Lancashire issue regarding cotton and textiles, other difficulties seem to have arisen. The hope entertained by the Government of India that it would be possible to announce before the end of the Simla session (September 1938) that the principles of the Agreement had been settled between the Board of Trade and the Government of India has thus been frustrated. Once again it is necessary for the latter to take up with the Board of Trade points raised by the non-official advisers and try to persuade the Board to accept them. For the moment (October 1938) we have to rest content with the assurance given by the Commerce Member in replying to a question in the Assembly by Mr S. Satyamurthi that the Government were trying to do whatever they could to bring about an agreement acceptable to both the parties.

The importance of an early settlement of this long-drawn-out controversy cannot be gainsaid. Indian opinion is getting restive over the indefinite extension of the Ottawa Agreement, the continuance of which was disapproved over two years ago by the Legislative Assembly.[1] So long as this question is not settled one way or the other, it is found none too easy to start negotiations for trade agreements with countries other than the United Kingdom in pursuance of the Resolution passed by the Assembly in March 1936. Lastly, the period of protection at present enjoyed by the Indian textile industry will expire on 31 March 1939 and the question has to be determined early by a special Tariff Board whose appointment has been delayed pending the conclusion of a fresh Indo-British commercial treaty. The hope may be expressed that good sense will prevail on both sides and that the Indian point of view will be better appreciated by Lancashire and the British Board of Trade so as to make a reasonable trade agreement possible between the two countries in their mutual interests.

§11. **Other trade agreements.**[2]—We shall now review the other

[1] The apprehensions felt by the Assembly in this matter were given expression to by a Resolution moved by Mr S. Satyamurthi and carried by the House on 2 April 1938 recommending 'to the Governor-General-in-Council that no steps should be taken to conclude a fresh Indo-British Trade Agreement or any Trade Agreement of a similar nature without first consulting the Assembly'.

[2] See (i) *Report of the Millowners' Association, Bombay* (Annual).

(ii) *Indian Textile Journal*, 1933-4, 1934-5, July 1936, May 1937, May-September 1938.

(iii) *Review of the Trade of India* (Annual).

important trade agreements and consider in general the future of bilateral trade agreements so far as India is concerned. The trade agreements other than the Ottawa Agreement are: (i) The Indo-Japanese Trade Agreements of 1934 and 1937, (ii) The Bombay-Lancashire Textile Agreement, popularly known as the Mody-Lees Pact (1933), (iii) the abortive Indo-Lancashire Textile Talks (1938), and (iv) The Indo-British Trade Agreement (1935).

§12. **Genesis of the Indo-Japanese Trade Agreement (1934).**— We have already[1] referred to the denunciation of the old Indo-Japanese Trade Convention of 1904 by the Government of India in April 1933. The continuous depreciation of the yen since the beginning of 1932 placed Japanese exports to India in a very favourable position towards the end of 1932-3. Indian mills were faced with a serious crisis and the Government of India had to intervene. The increase in the import duties to 50 per cent *ad valorem* with a minimum specific duty of 5¼ as. per lb. on plain grey non-British cotton piece-goods in August 1932 was insufficient to meet the Japanese competition, and the Indian textile industry continued to agitate for additional protection. His Majesty's Government on behalf of the Government of India were thereupon compelled to give the necessary six months' notice to the Government of Japan of their desire to abrogate the old Trade Convention (1904) under which Japan enjoyed the privilege of the most-favoured-nation treatment. So long as the trade convention of 1904 remained in force it was not possible for the Government of India to take any action against Japan alone under the Safeguarding of Industries Act, passed in April 1933 by the Indian Legislature, which empowered the Government to take tariff action whenever the trade and industry of the country was threatened by cheap imports from foreign goods. The decision of the Government of India to denounce the Indo-Japanese Trade Convention led to a movement in Japan for the boycott of Indian cotton by way of reprisal. But the agreement between the Japanese spinners and raw cotton dealers not to accept Indian cotton was not definitely reached until after the promulgation in India of the tariff changes of June, 1933, which announced an increase in the duty on foreign (including Japanese) cotton piece-goods to 75 per cent *ad valorem* with a minimum specific duty of 6¾ annas per lb. on plain greys. A Japanese delegation came to

(iv) *Indian Finance*, Indo-Japanese Trade Agreement Supplement, 15 July 1936.

(v) *Report of the Special Tariff Board on Textile Industry* (1936).

(vi) *Reports of the Indian Merchants' Chamber* (Annual).

(vii) M. P. Gandhi, *The Indian Cotton Textile Industry* (1938 Annual).

[1] See p. 38.

India and met the official and non-official representatives of the Government of India at Simla in October 1933. After negotiations lasting more than three months, an agreement was reached between the two sides. The Japanese boycott was withdrawn in January 1934 and at the same time the 75 per cent duty was reduced to 50 per cent by the Government of India. A new reciprocal commercial treaty was drawn up, and was signed in London on 12 July 1934, although the provisions relating to the regulation of imports of Japanese piece-goods had come into force earlier, i.e. on 8 January 1934.

§13. **Provisions of the Agreement (1934).**—The Agreement of 1934 with Japan consisted of two parts, the Convention and the Protocol. The Convention laid down in broad outline the trade relations between the two countries in future, and the Protocol specified the agreement reached regarding the importation of cotton piece-goods from Japan into India and the export of raw cotton from India to Japan. The Protocol without the Convention was to come to an end automatically on 31 March 1937, and the Convention would terminate on the same date, if denounced by either of the contracting parties by giving six months' notice.

The main provisions of the Convention were as follows: (i) Both the contracting parties agreed to extend to each other the most-favoured-nation treatment. (ii) At the same time both the parties had the right of imposing or modifying from time to time special customs duties on the imports from each other at such rates as might be necessary to correct the effect of any variation in the exchange value of the yen or the rupee in relation to the rupee or the yen respectively, subsequent to 31 December 1933. (iii) While both the parties reserved the right to make such changes in their customs tariffs as might be necessary for the protection of their own interests, they were agreeable, when requested to do so by either of them, to enter into negotiations with the object of reconciling as far as possible the interests of the two countries.

The principal articles of the Protocol were as follows: (i) The customs duties to be imposed on importation into India were not to exceed the following rates:

(*a*) *Plain greys.* 50 per cent *ad valorem* or $5\frac{1}{4}$ annas per lb., whichever is higher;

(*b*) *Others.* 50 per cent *ad valorem.*

(ii) Article 3 of the Protocol prescribed a system of quotas for the imports of Japanese cloth into India and the export of raw cotton from India. Under this arrangement Japan was allowed to export to India in any cotton piece-goods year (i.e. the year beginning on 1 April) 325 million yards of cloth provided she

purchased one million cotton bales from India in any cotton year (i.e. the year beginning on 1 January). This was the basic quota. The largest quantity of cotton piece-goods that Japan could send to India was fixed at 400 million yards a year. For this purpose the basic allotment of 325 million yards was to be increased by 1½ million yards for every 10,000 bales of the excess over 1 million bales taken in any cotton year. The quota fixed for raw cotton and cotton piece-goods was exclusive of re-exports.

(iii) The sub-allotment of the cotton piece-goods which might be sent to India in any year was divided into four categories as follows:

(*a*) Plain greys 45 per cent. (*b*) Bordered greys 13 per cent. (*c*) Bleached (white) goods 8 per cent. (*d*) Coloured (printed, dyed or woven) goods 34 per cent.

§14. **Working and results of the Indo-Japanese Trade Agreement (1934).**—The conclusion of the Indo-Japanese Trade Agreement of 1934 removed the ill-feeling prevailing in both the countries and brought relief to the cotton grower, the cotton merchant and, to a certain extent, to the mill-owner in India. The greatest gain from the Agreement was secured by the Indian cotton grower, who succeeded in exporting to Japan cotton in quantities appreciably larger than the quota fixed under the Agreement. The betterment of his economic position was also calculated to help the local textile industry since the masses are the largest consumers of local fabrics.

Japan also realized substantial advantages. In the first place, she secured the most-favoured-nation treatment (which incidentally has adversely affected some of the nascent and minor industries in this country). The reduction in the customs duty on Japanese exports of piece-goods to India from 75 per cent to 50 per cent, which, in the opinion of Indian mill-owners, gave inadequate protection to the industry, was also another big gain to Japan.

From the Indian standpoint the Indo-Japanese Trade Agreement of 1934 was adversely criticized, and the feeling in the country was that India did not come off well in the bargain. The greatest dissatisfaction was expressed against the working of the quota system. The non-official advisers to the Government of India in the Indo-Japanese trade parleys for the renewal of the Trade Agreement, which began in July 1936, declared that the quota arrangement had failed to maintain the price level in the cotton textile industry and had lent itself to a considerable amount of evasion. The Japanese as well as the Indian merchants in Japan promptly took advantage of the loopholes in the quota system, and thus frustrated its main object, namely the limitation of the amount

of cloth coming from Japan. Fents[1] were outside the quota, and though Japanese manufacturers and exporters did not send any considerable quantity of cloth in this form, Indian merchants in Japan developed a big trade in it in recent years. So also artificial silk goods were not included under the quota, and large quantities of them were imported into India from Japan. Another ingenious method adopted by Japanese exporters to circumvent the quota arrangement was to send made-up cotton goods such as shirts, dresses, skirts, etc., which have in recent years flooded the Indian market. It was also alleged that considerable quantities of Japanese piece-goods, re-exported from India to Afghanistan and Nepal, were smuggled back across the border into British Indian territory. Thus it was shown that Japanese exports to India had in spite of the Protocol increased, and thus defeated its agreed purpose. The linear yard basis had been abused, and cloth of greater width had been exported to India.

It was further pointed out that Japan had taken full advantage of the most-favoured-nation clause in the Agreement, and had dumped large quantities of cheap miscellaneous manufactured goods such as glassware, boots, shoes, hardware, woollen goods, cycles and umbrellas. This had adversely affected the position of a number of small nascent Indian industries and handicrafts. Customs statistics showed that the imports of miscellaneous Japanese products into India had in recent years risen by several crores of rupees, so that Japan's adverse balance of trade with India had been wiped out. Japanese purchases of Indian pig-iron, jute and oilseeds had considerably diminished. On the other hand, the range of goods imported from Japan, as also the quantities imported, had appreciably increased. It was, therefore, argued that a comprehensive trade agreement was necessary rather than an agreement restricted to the barter of raw cotton against cotton piece-goods.

As regards the large purchases of Indian cotton made by Japan in excess of what the Protocol contemplated, it was urged that Japan bought all this cotton not as a favour to India, nor under compulsion under the Protocol, but because she wanted a cheap raw material. During 1934-5, the first complete year since the operation of the Indo-Japanese Trade Agreement, she bought 2,010,600 bales of Indian cotton. Her average cotton takings from India for the previous ten years were a million and a half bales. It was, therefore, maintained by non-official commercial opinion in India that the minimum off-take of Indian cotton by Japan should be increased from 1 million to at least 1½ million. It was argued

[1] Fents are rejected cuttings of cloth pieces which are imported at a smaller customs duty, being below the standard length.

that the cotton off-take of Japan would not diminish for some years unless the Japanese replaced cotton in their industries by staple fibre.

§15. **New Indo-Japanese Trade Agreement (1937).**—All these points of criticism against the Indo-Japanese Trade Agreement of 1934 received a great deal of attention during the protracted negotiations which commenced in July 1936 for the renewal of the Trade Agreement of 1934 which was to expire on 31 March 1937. The non-official Indian advisers to the Commerce Department of the Government of India, who met in Simla in July 1936, were united in their demands, unlike on the previous occasion in 1933. In the first place, it was recommended that while the agreement concerning the Japanese off-take of Indian cotton should continue as at present, there should be a substantial reduction (say by fifty million yards) in the quantities of Japanese cotton piece-goods imported into India. It was also urged that there should be a quota for fents and that it should not exceed an amount equal to 2½ per cent of the general cotton piece-goods quota. It was further proposed that to check the growing imports of artificial silk piece-goods into India from Japan, these goods should be included in the general piece-goods quota. The same procedure should be adopted as regards made-up cotton-cloth garments. The quota should be fixed on the square-yard basis instead of the linear yard basis. A further recommendation was that low-grade Japanese yarn (that is, yarn of staples up to 50s) should be subject to a quota. Finally it was urged that under the new agreement there should be either quotas for imports of miscellaneous goods, or such higher specific import duties as would protect the small home industries of India.

After negotiations lasting for nearly nine months, the revised Indo-Japanese Trade Agreement was initialled on 12 April 1937 and was subsequently formally signed in London. It came into force, however, from 1 April 1937 and is to have effect until 31 March 1940.

As regards the Trade Convention the *status quo* has been preserved and Japan is thus assured of the most-favoured-nation treatment for a period of three years.

The new cotton Protocol is substantially the same as the old one except for a few modifications, some of which were necessitated by the separation of Burma from India from 1 April 1937. The annual basic import quota of Japanese piece-goods has been reduced from 325 million yards to 283 million yards against the purchase by Japan of Indian raw cotton of one million bales. The reduction of 42 million yards in the import quota was effected in view of the shrinkage of the Indian market following the separation of

Burma from India. Similarly, the maximum limit of imports of cotton piece-goods, which is conditional on Japan's taking 1½ million bales of raw cotton from India, has also been reduced from 400 to 358 million yards.

In the new Protocol, the coloured piece-goods have been subdivided into the categories of (i) printed goods and (ii) dyed or woven goods, and the percentage quota apportioned to coloured piece-goods has been increased from 34 to 37. The total quota has been allotted as between the several categories in the following percentages: (*a*) plain greys, 40 per cent, (*b*) bordered greys, 13 per cent, (*c*) bleached (white) goods, 10 per cent, (*d*) coloured printed goods, 20 per cent, and (*e*) coloured dyed or woven goods, 17 per cent. The basic quota of cotton piece-goods is exclusive of the cotton fents, but Japan has undertaken to limit imports of cotton fents into India to 8,950,000 yards annually. The Government of India have agreed that customs duties on cotton fents shall not exceed 35 per cent *ad valorem*.

§16. **A critical estimate of the new Indo-Japanese Trade Agreement (1937).**—The new Agreement with Japan, which has been in force since 1 April 1937, is essentially a compromise and has failed to satisfy the commercial community in Bombay as well as the Indian textile industry. It is felt that the Agreement falls short of the unanimous and reasonable recommendations made by the non-official advisers to the Government of India and that it is not better than the old Agreement of 1934. The Government of India could have secured better terms, including protection of the minor industries, which have been suffering owing to Japanese competition. The Trade Convention has been continued on the existing basis without reference to the demand for protection against Japan put forward on behalf of the small indigenous industries. The *status quo* has thus been preserved in the general trade relationship between the two countries. The Agreement is to that extent a gain for Japan.

As regards the cotton Protocol, the main difference from the previous one is, as explained above, necessitated by the separation of Burma with whom Japan has already concluded an agreement under which the Burmese quota for Japanese piece-goods has been fixed at 42 million yards. The Indian quota has accordingly been reduced by an equivalent amount. It should be borne in mind, however, that Burma's requirements as judged from the figures of the previous two years are about 70 million yards annually, which was included in the basic quota of the old Protocol. Since the separate Burmese quota has been fixed at 42 million yards only, India will have to absorb 28 million extra yards, as her quota is reduced

by 42 million yards only and not by 70 million yards as it ought to have been. Of course, the off-take of Indian cotton by Japan has not been reduced, but this, it is argued, is immaterial since Japan needs Indian cotton to manufacture her large cotton piece-goods exports. True, Burma will be an open market, but India will have to compete there with foreign countries and especially with Lancashire. While the subdivision of the category of coloured piece-goods is to India's advantage, the increase in the percentage quota of this category is not justifiable having regard to the fact that Japan is a serious rival of India in this variety of goods.

It is also unfortunate that cotton fents have not been included in the quota of cotton piece-goods, although it is some consolation that the maximum quantity of cotton fents that may be exported to India annually is limited to 8,950,000 yards, i.e. 2½ per cent of the quota of cotton piece-goods. But the promise of the Government of India that the customs duty on cotton fents will not exceed 35 per cent *ad valorem* is considered unfavourable to India.

The exclusion of silk fents and artificial silk piece-goods from the scope of the Agreement has been adversely criticized. But the Indian mill industry and the indigenous silk industry have been assisted by the recent (1937) Finance Department Notification prohibiting imports of artificial silk fents into India and the raising of the import duties on artificial silk piece-goods by an average of an anna per square yard.

Some of the suggestions made by the non-official advisers have not been accepted; for example, no quota limitation has been placed on the extraneous imports of made-up goods, towellings, cotton blankets, and re-exports over India's land frontiers to the neighbouring markets of Nepal and Afghanistan.

Disappointment was also felt that the Government of India did not take the opportunity offered by the Trade Agreement to check the intrusion of Japan into the coastal shipping trade of India and to ensure for India a fair share in the carrying trade between Japan and India.

In justification of the new Indo-Japanese Agreement it may be said that the interests of the cotton grower had to be safeguarded first, and in view of the threat of Chinese cotton strengthened by the new five-year plan it is gratifying that the off-take of Indian cotton for three years has been stabilized.[1] In this connexion we

[1] It should be noted, however, that owing to the Sino-Japanese hostilities and the difficulties experienced by Japan in commanding foreign exchange, she has considerably reduced her purchases of Indian cotton, the figure of export from India being 1,359,092 bales of cotton in 1937-8 as compared with 2,426,049 bales in 1936-7.

should do well to remember that India at present needs an effective outlet for much of the cotton she grows. The Indian mills absorb roughly 50 per cent of the five million bales of cotton produced in the country. Although there is some scope for the expansion of the Indian cotton textile industry, and although Lancashire mills are using more Indian cotton than before, it cannot be denied that there will continue to be a substantial export surplus of Indian cotton. The continental demand for Indian cotton is not guaranteed and will not in any case absorb more than a small percentage of our cotton. Japan is today the largest single buyer of Indian cotton and therefore, to a certain extent, holds the key position. It is not altogether wise to assume that Japan must and will buy our cotton. She has alternative sources in America, China and Egypt. At the same time our position as sellers of cotton to Japan is not so weak that Japan can dictate terms to us.

On the whole, the new Agreement is not worse than the old one, and India's position is stronger under the revised Protocol. It is felt, however, that the Government of India could have utilized our bargaining power to the fullest extent in India's interests. Also it would have been very desirable if instead of a barter agreement of raw cotton against cotton piece-goods, a comprehensive trade agreement, including proper safeguards for the nascent small industries of India like glass and glassware, hosiery, soap, enamel ware, chemicals, etc., had been concluded with Japan. Owing to Japan's preoccupation with the Sino-Japanese war, the tension of the Japanese competition in the Indian market has been somewhat relaxed for the time being. But at any moment that competition may once again become acute.

§17. **The Bombay-Lancashire Textile Agreement (Mody-Lees Pact).**—At about the time the negotiations for the Indo-Japanese Trade Agreement (1934) were in progress, following the conference between the representatives of the Indian and British cotton textile industries in Bombay in September 1933, an understanding was reached to which the respective parties were the Millowners' Association, Bombay, then presided over by Mr (now Sir) H. P. Mody and the British Textile Mission to India led by Sir William Clare Lees. This agreement is popularly called the Mody-Lees Pact. There were sharp differences among the representatives of the Indian textile industry, and the attempt to secure a common front failed. It was, however, found possible for Lancashire to conclude an agreement with the Millowners' Association, Bombay, which represented nearly 50 per cent of the total looms and spindles installed in the country.

The main features of the agreement which was signed on 8 October 1933 at Bombay and which was to remain in operation till 31 December 1935, were as follows:

(i) It was agreed that the Indian cotton textile industry was entitled to a reasonable measure of protection against the imports of the United Kingdom yarns and piece-goods. It was also agreed that under the present conditions, owing to lower costs and other factors operating in foreign countries, the industry required a higher level of protection against them than against the United Kingdom.

(ii) As regards cotton piece-goods, it was agreed that, if and when the revenue position of the country made it possible for the Government of India to remove the general surcharge on all imports imposed in October 1931, the Indian side would not make fresh proposals with regard to the duties applicable to the United Kingdom imports.

(iii) A lower scale of duties on cotton yarns and artificial silk piece-goods imported into India from Lancashire was agreed to on the Indian side.

(iv) In so far as the Empire and other overseas markets were concerned, it was agreed that any advantages which might be arranged for British goods should be extended to Indian goods, and that India should participate in any quota which might be allocated to the United Kingdom in markets in which India had no independent quota. In respect of overseas markets in which the Indian mills were without established connexions, it was agreed that the Manchester Chamber of Commerce should use its good offices to bring about contacts between Indian manufacturers and British houses already established in those markets.

(v) In regard to raw cotton, an undertaking was given that the British Textile Mission would be prepared to recommend effective action being taken to promote the use of the Indian raw material and keep the Indian side regularly in touch with developments. It was further agreed that other avenues of co-operation in this field should be explored in the interests of the Indian cotton grower.

The Bombay-Lancashire Agreement was the first attempt to achieve by agreement the co-ordination of Indian and British interests. In the judgement of some people, the Agreement had abundantly justified itself. It had brought about a very considerable increase in the off-take of Indian cotton by Lancashire (thanks to the efforts of the Lancashire Cotton Committee to bring about an increased use of Indian cotton in Lancashire mills), and thus conferred much benefit on the Indian agriculturist. (See however

note on p. 654.) It had further earned the sympathy of Lancashire for the progress of Indian constitutional reforms; and had demonstrated the way British and Indian commercial interests could live together in a spirit of friendly rivalry instead of in the old atmosphere of mutual suspicion and distrust. Lancashire had also frankly recognized the need for adequate protection to the Indian textile industry as against itself, and offered its good offices to promote the interests of the Indian textile industry in overseas and colonial markets.

On the other hand, the critics of the Agreement argued that it had not the support of the whole Indian textile industry and that, while India had conferred substantial and definite benefits (i.e. reductions in duties on cotton and artificial silk piece-goods) on Lancashire, the latter merely made certain promises without any definite commitments. The Agreement had meant the withdrawal of much of the protection previously enjoyed by the Indian industry: As to overseas markets, since the Bombay mills were unable to stand unaided even in the home market, they could hardly be expected to make much headway in the overseas markets even with the help and good-will of Lancashire. Lastly, as regards the use of Indian cotton by Lancashire mills, the Agreement merely held out a vague promise and did not require Lancashire to buy a minimum quantity of Indian cotton as in the case of Japan.

§18. **Lancashire delegation to India (1938).**—We have already (ch. ii, §12) seen that the Indian Tariff (Textile Protection) Amendment Act, which became law on 1 May 1934, gave statutory effect to the scale of duties which had been agreed to under the Mody-Lees Pact and to the Indo-Japanese Agreement of 1934. We have also pointed out (ch. ii, §13) that in accordance with the recommendations made by the Special Textile Tariff Board (1935-6), which reviewed the tariff rates on British goods on the expiry of the two years covered by the Bombay-Lancashire Textile Agreement, the duties on British cotton piece-goods were reduced from 25 to 20 per cent in the case of plain grey goods, the duty being 25 per cent in the case of printed goods. The level of duties on non-British cotton piece-goods remained as under the Act of 1934 at 50 per cent *ad valorem*.

The question of further revising the duties on Lancashire piece-goods imported into India and of generally regulating that trade in relation to Lancashire's purchases of Indian cotton recently (May 1938) came into prominence during the textile negotiations at Simla between the Lancashire delegation headed by Mr A. D. Campbell and the Indian non-official advisers (led by Sir Purshottamdas Thakurdas) who have been dealing with the proposed Indo-British

Trade Treaty. As we have already pointed out (see § 10) the negotiations for the revision of the Ottawa Agreement have been hanging fire for the last two years and more. When the Indian non-official advisers were in London in the summer of 1937, it became evident that the crux of the Agreement lay in a settlement with Lancashire. This explains the decision of Lancashire to send out a delegation to India to explore the possibilities of obtaining a small but definite share of the Indian market for her piece-goods in exchange for purchase of Indian cotton as part of the general Indo-British trade treaty. The reduction in the duties on Lancashire piece-goods in June 1936 has not helped Lancashire in maintaining her position in the Indian market. In 1937-8 Lancashire was able to export to India 343 million yards (266 million yards excluding Burma) only as compared with 1,500 million yards ten years ago. Hence Lancashire is anxious to secure for herself a small but tangible share of the Indian market.

§ 19. **Breakdown of the Simla textile talks.**—There were three principal issues involved in the recent textile talks at Simla. The question of the quota of piece-goods to be allotted to Lancashire, the fixation of tariff duties on Lancashire imports, and the question of purchase of Indian cotton by Lancashire in consideration of the quota of piece-goods allotted to her in the Indian market. It appears that Lancashire at first required a guaranteed market for about twice as much cloth as is sold now and an elastic (sliding) scale of duties (ranging from $17\frac{1}{2}$ per cent to $7\frac{1}{2}$ per cent) to give the certainty that it was purchased. This meant a substantial reduction in the duties even below the level of revenue duty, viz. 15 per cent. As regards the purchase of Indian cotton, the Lancashire delegates were prepared to give an assurance that they would as in former years do their best to buy increasing quantities of Indian cotton but they were not willing to give a definite written undertaking to purchase a substantial specified quantity of Indian cotton every year.

Lancashire's general argument was that the offers made to India in other directions in the course of the negotiations for a revised Indo-British Trade Agreement were very good value having regard to the world economic conditions and the recent trend of the merchandise balance as between the two countries, which was not only even, but actually in favour of India.

On the Indian side, there was no opposition to the Lancashire demand in principle, and it was recognized that it was highly desirable to ensure a growing outlet for Indian cotton in Lancashire, especially in view of the uncertainty regarding Japanese purchases of Indian cotton. But the textile talks at Simla broke down

towards the end of May 1938 owing to the wide gulf between the view-points of the two sides. The Indian non-official advisers were opposed to the principle of an elastic scale of import duties on Lancashire piece-goods and to any reduction of the tariff rate below the average level of 15 per cent, which is regarded as the minimum duty for an industry supposed to be protected. Nor were they inclined to accept Lancashire's demand for a quota at twice the present level of imports. Lancashire's reluctance to agree to a guaranteed off-take of Indian cotton and her mere 'good-will' assurance to encourage the use of Indian cotton failed to evoke enthusiasm among the Indian delegates.[1]

In spite of the intervention of Sir M. Zafrullah Khan, the gulf between the two sides could not be narrowed. The textile talks had to be abandoned and the Lancashire delegation returned to England in May 1938. The matter was then taken up by Mr Oliver Stanley, President of the British Board of Trade, who declared that it was not possible to conclude a trade agreement with India unless there was a satisfactory settlement of the cotton question and fair treatment could be obtained for British cotton goods in India. Later Sir M. Zafrullah Khan resumed the negotiations. He specially flew to England in June 1938 to have further talks, which resulted in the British Board of Trade making a revised offer. From lobby conversations in Simla, it would appear that the British Board of Trade wants a reduction in the present scale of duty to 15 per cent and an import quota of 500 million yards maximum and 350 million yards minimum for Lancashire. As regards the off-take of Indian cotton, the British Board of Trade offers no guarantee, but only gives the assurance to consume 400,000 to 500,000 bales annually.[2]

The non-official Indian advisers, after considering these terms, submitted their Report to the Government of India on 7 September 1938, rejecting them by a majority of five against two. The Government of India is at present (October 1938) considering the issues raised in this Report.

Although it is not possible at this stage to say the last word on the Lancashire controversy since the details of the latest proposals brought by the Commerce Member have not yet been made officially

[1] It is noteworthy that while India exported to the United Kingdom 456,142 bales of cotton in 1935-6, and as much as 622,423 bales in 1936-7, in 1937-8 the amount purchased by Lancashire declined to 395,102 bales. The spurt in 1936-7 thus appears to be temporary.

[2] See article by A. S. Aiyangar, 'The Crisis in Indo-British Trade Relations', *The Indian Textile Journal* (September 1938).

available to the public, a few general observations may be made. The Lancashire expectations appear to be pitched far too high. The range of competition between the goods sent by her and those manufactured by Indian mills is growing, and Indian costs of production have steadily fallen. A reduction of the import duty will not materially help Lancashire unless it is very drastic, which is not feasible as the Indian textile industry is a protected industry.[1] The real trouble is the inability of Lancashire to quote competitive rates in comparsion with the quotations for Indian and Japanese piece-goods in the Indian market, which is essentially a price market. Then again the Indian textile industry is entitled to a certain right of expansion and the claims of the handloom industry also cannot be ignored.

Lancashire's offer to buy Indian cotton is not very tempting. In the first place, it is well known that Lancashire requires mostly long-staple cotton. Now the demand for such cotton by Indian mills is rapidly increasing and the questions arise whether Lancashire is prepared to absorb a proportion of the other varieties and what supply of long-staple cotton is likely to be available. As it is, India is importing a growing amount of long-staple cotton mostly from East Africa, and it is certainly desirable to replace this by home-grown cotton. Having regard to the uncertain demand for Indian cotton in foreign markets it has been suggested that it would be desirable for India to increase the internal consumption of her cotton by further expansion of her textile industry and development of export markets for her surplus mill production.[2] The whole question has now to be considered in its wider relationship to the Indo-British Trade Treaty, and we can only wait upon time until this knotty problem is solved.

§20. **The Indo-British Trade Agreement (1935).**—The Bombay-Lancashire Agreement (1933) was followed up by the Indo-British Trade Agreement in 1934 (actually signed on 9 January 1935). The Agreement was supplementary to the Ottawa Trade Agreement (1932) and was to be in force during the currency of the latter Agreement.

[1] It should also be borne in mind that the textile industry in India has had recently (1938) to grant an increase in wages on the recommendations of Provincial Labour Textile Enquiry Committees. Moreover, so far as the finer fabrics manufactured by Indian mills are concerned, they have to pay $7\frac{1}{2}$ per cent duty on foreign (long-staple) cotton, which has to be imported for the purpose.

[2] The feeling among some representatives of Indian cotton-growers appears to be that the breakdown of the textile talks at Simla was due to the unreasonable attitude of the representatives of the Indian textile industry, who were opposed to allow Lancashire a quota of piece-goods limited to the average of the last three years. It is felt that the point of view of the cotton-grower has not been adequately represented.

The following are the principal undertakings on the part of the signatories:

(i) It is recognized that while protection to an Indian industry may be necessary in the interest of the economic well-being of India, the condtions may be such that an Indian industry requires a higher level of protection against foreign goods than against imports of United Kingdom origin.

(ii) His Majesty's Government recognize that under existing conditions import duties constitute an indispensable element in the revenues of the Government of India and that revenue considerations must be given due weight in fixing the level of import duties.

(iii) The Government of India undertake that protection will be afforded only to such industries as after due inquiry by the Tariff Board have, in the opinion of the Government of India, established claims thereto in accordance with the policy of discriminate protection. The measure of protection to be afforded shall be only so much as, and no more than, will equate prices of imported goods to fair selling prices for similar goods produced in India,[1] and subject to this condition, lower rates of duty whenever possible shall be imposed on goods of United Kingdom origin.

(iv) When the question of the grant of substantial protection to an industry is referred to the Tariff Board, the Government of India will afford full opportunity to any industry concerned in the United Kingdom to state its case and answer cases presented by other interested parties. The Government of India further undertake that in the event of any radical change in the conditions affecting protected industries during the currency of the period of protection, they will on the request of His Majesty's Government, or of their own motion, cause an inquiry to be made as to the appropriateness of existing duties from the point of view of the principles laid down in Article (iii) above, and that in the case of such an inquiry full consideration will be given to any representation which may be put forward by any interested industry in the United Kingdom.

(v) His Majesty's Government will give consideration to the steps that might be taken to develop the import from India of raw or semi-manufactured materials used in the manufacture of articles which are subject to differential import duties in India. They also undertake to take further steps to stimulate the use of Indian cotton (in pursuance of Article 8 of the Ottawa Agreement) in all possible ways, including research, commercial investigation, market liaison, and industrial propaganda.

[1] See ch. i, pp. 9-10, n. 2.

(vi) His Majesty's Government undertake to continue the privilege of duty-free entry of Indian pig-iron into the United Kingdom so long as the duties on articles of iron and steel imported from the United Kingdom into India are not less favourable than those provided for in the Iron and Steel Protection Act, 1934.

By an exchange of notes, His Majesty's Government undertook to invite the Governments of the Colonies and Protectorates to accord the same favourable treatment to Indian cotton goods as may be proposed for similar United Kingdom cotton goods in order to facilitate their sale in competition with foreign cotton piece-goods. Likewise the Government of India undertook that as soon as the second surcharge comes off as a general measure, the tariff rates on the United Kingdom cotton piece-goods would be reduced to 20 per cent *ad valorem* or 3½ annas per lb. on plain grey goods, and 20 per cent *ad valorem* on other goods, provided that, on the expiry of the period of the Bombay-Lancashire Agreement of 28 October 1933, the duties on the United Kingdom goods for the remaining period of protection would be fixed on a review of conditions then existing and in the light of such experience as may have been gained.

§21. **A critical review of the Indo-British Trade Agreement (1935).**—The Indo-British Trade Agreement had a hostile reception in the country. The business community felt aggrieved that commercial opinion in India had not been consulted. The Legislative Assembly, when called upon to take into consideration the new Agreement, passed a resolution for its termination (January 1935). The official defence put forward by Sir Joseph Bhore was that the Agreement was merely a formal statement of the principles and practices of discriminating protection which had from time to time received the approval of the Indian Legislature. There was no necessity to consult commercial opinion as no new departure of principle or practice was involved. The Fiscal Autonomy Convention was not changed, nor was the policy of discriminate protection. The Agreement was justified on the ground that while British interests did not desire to question the existing policy regarding discriminate protection, etc., they wished Indian policy to be defined and clarified so that there would be no misunderstanding hereafter. The Agreement, it was maintained, 'implemented implied promises given at Ottawa and the definite promises given to the Clare Lees Deputation'. The Agreement conferred on India material benefits under Articles V and VI, regarding the increased consumption of Indian cotton and of raw and semi-raw materials, and the privilege of duty-free entry of Indian pig-iron into the United Kingdom. India was also promised a share in such facilities as

might be granted to British cotton goods by the Colonies and Protectorates.

On the other hand, the representatives of non-official commercial opinion in India strongly criticized the Agreement on the ground that it whittled down the Fiscal Autonomy Convention, as also valuable principles of discriminate protection established since 1923. There was also absence of reciprocity, the Agreement being drawn more in the interest of the United Kingdom than of India. While India gave certain definite undertakings, the United Kingdom merely offered to consider various steps that might be taken to develop the use of Indian cotton, etc., and extended certain vague promises to India of little or no material use in the near future.

It was also argued that the Agreement enunciated principles far more dangerous than any quotas or reductions in the percentages of duties. It was not desirable to reopen the question of protection when once it had been granted for a definite period, especially at the instance of the United Kingdom. Such a policy was likely to be an impediment to the industrial development of India and to hamper the starting of new industries.

The defenders of the Agreement maintained that even under the new Agreement India retained complete freedom to control her tariffs. As regards the reopening of the question of protection, it was pointed out that the Government of India had never abandoned the duty of re-investigating the case of an Indian industry, if radical alterations occurred in the conditions affecting the industry. Sir Joseph Bhore also added that Indians had a statutory right under the British Import Duties Act of putting their case before the Board of Trade in the United Kingdom.

§22. **The new policy of bilateral trade agreements.**—An outstanding feature of the history of recent commercial policy, especially since 1932, has been the increasing activity displayed by a number of trading countries, particularly in Europe, in the conclusion of short-term bilateral trade agreements. This offers a striking contrast to the old trade policy, based on the most-favoured-nation principle which was until recently widely in operation.

Of the many types of bilateral agreements the most common are: (i) Clearing and (ii) Compensation or Barter Agreements. The latter provide for the direct exchange of goods and thus obviate the necessity of devising means of payment. Such agreements may be entered into between two Governments or two private persons or firms in the two countries. The clearing agreements do not specify the particular commodities to be exchanged. They are designed mainly to regulate bilateral trade so as to produce as far as possible an exact balance of exports and imports and to regulate foreign

exchange.[1] It is no doubt still customary to insert the most-favoured-nation clause in such bilateral agreements; but the operation of the clause is rendered nugatory by the simultaneous inclusion of provisions relating to financial and quota arrangements, industrial undertakings, regional preferences, etc.

§23. **The movement for bilateral agreements in India.**—The business community in India views with great alarm the deterioration of India's trade balance in merchandise in recent years owing to the imposition of various restrictions by India's foreign customers especially in Europe in the form of prohibitions, monopolies, quotas, exchange restrictions, license systems, etc. The general tendency to planned trade on the basis of trade treaties and the example of the United Kingdom herself in concluding such treaties have strengthened the movement in India for a comprehensive policy of trade development through bilateral trade agreements. The Government of India are being urged to enter into bilateral agreements with all the important countries with which India has commercial relations, especially with Germany, Italy, Iran and Turkey, whose policies of regulated commercial exchange have had particularly serious repercussions on India's export trade. The issue before the country is: should India abandon her traditional policy of the universal most-favoured-nation treatment in favour of a system of bilateral trade agreements? Point has been lent to this controversy by the vote of the Legislative Assembly (March 1936) in favour of the termination of the present Ottawa Agreement and the adoption of Mr Jinnah's amendment to the Government motion recommending that the Government should examine the trend of India's trade with a view to entering into bilateral trade treaties.[2]

§24. **The case against bilateral agreements.**—While the Government of India seem thus to be committed to the policy of bilateral treaties, they are not convinced of the desirability of adopting such a policy. In their judgement nothing in the study of the world economic conditions in the past few years, or in India's present circumstances, has shown that any departure from the accepted policy is necessary.[3] It is urged that India's export trade consists mainly of comparatively few raw materials sent to the great world

[1] See *Press Note III on India's Foreign Trade Policy* (1936) issued by the Director of Information with the Government of India; also Paul Einzig, *Exchange Control*, pp. 151-2.

[2] See §9 above.

[3] The grounds on which this conclusion is based have been set forth in the Press Notes issued in March 1936 by the Director of Information with the Government of India regarding India's foreign trade policy. See also B. K. Madan's article, 'Bilateralism and Indian Trade', *Indian Journal of Economics* (July 1938).

markets, and it is essential for her prosperity that she should have a favourable balance of trade and should have, to the greatest extent possible, free and unrestricted access to these markets. She can therefore ill afford to risk the closing of any door now open to her by virtue of most-favoured-nation rights. Not only do bilateral trade agreements tend to produce immediate diminution of the total trade of the contracting parties, but the diversion of trade from its natural channels is also likely to inflict serious damage on third parties. The policy of preferring a favourable balance to an increase in the total volume of trade must lead to the extinction of all trade balances and the permanent shrinkage of international trade. India stands to lose rather than to gain by adopting a policy which at best would reduce her foreign trade to a balance of exports and imports. Restriction of imports, it is maintained, may be a regrettable necessity in the case of ' distress ' countries like Germany, but the adoption of such a measure by reasonably prosperous countries like India would be sheer defeatism.

As regards bilateral agreements with countries like Germany, Italy, Iran and Turkey, we are invited to bear in mind, in the first place, that India has normally a favourable balance of trade with these countries, i.e. she sells more to them than she buys from them. A country which is prepared to restrict its imports will always drive a hard bargain with another anxious to sell. Moreover, the exports of these countries to India would directly compete with the products of Indian industries. It must also be borne in mind that India no longer holds a dominant position in the world's markets as a supplier of food and raw materials. For instance, Germany is now obtaining large quantities of raw materials formerly bought from India from countries with whom clearing agreements have been made. Thus cotton is being obtained from Brazil, Peru, Egypt and Turkey, hides and skins from South America, oil-seeds from the Argentine and the French Colonies, and so on. Allowance has also to be made for the fact that the uncertain character of the general economic conditions and of the currency situation in these countries would militate against sound bilateral agreements being made with them.

There are difficulties to be faced with other countries. For example, France is paying a great deal of attention to the encouragement of imports from her Colonies and has grown to like the milder and more delicate-flavoured China tea better than Indian tea. Again, the United States of America is still bent on its isolationist tactics and is concentrating on internal commerce and development rather than on foreign trade. Thus the conclusion of successful bilateral agreements with these countries will be a very difficult matter.

If a long view is taken, it must be remembered that India cannot isolate herself from the world and retain her present importance as a commercial unit. She must seek an outlet for her surplus produce in world markets, and her ultimate prosperity is dependent on the general prosperity of the world trading community. Her true interest therefore lies in the restoration of the free and unrestricted flow of international trade on which world prosperity depends.

§25. **The need for bilateral agreements.**—On the other side, however, it can be argued that the prospects for world recovery and restoration of freedom in international trade are at present far from bright. The present tendencies towards economic nationalism, self-sufficiency and bilaterism in trade are likely to be intensified rather than diminished in strength in the near future. In these circumstances, India must fall in with the new policy of trade regulation in sheer self-defence, and she has already made a beginning in the Ottawa and Indo-Japanese Trade Agreements.

Great Britain and Japan are no doubt two of our most important customers and it is highly desirable that we should have Trade Agreements with them on as advantageous terms as we can secure. We must, however, as suggested in the Assembly's Resolution denouncing the Ottawa Agreement in March 1936, cast our net wide and fully explore the possibilities of suitable bilateral agreements with other customers also, such as the United States of America,[1] Germany, Italy, Turkey, Iran, Canada, Ireland, Australia,[2] Ceylon, East Africa,[3] Afghanistan[4] and Egypt,[5] and endeavour to secure some relief from the various restrictions to which our exports

[1] The Foreign Secretary in reply to a question in the Simla session (1938) of the Assembly replied that correspondence was at present taking place between the Government of India and His Majesty's Government in the United Kingdom with a view to exploring the possibility of a commercial treaty between India and America.

[2] The Australian Delegation on their way to London in April 1938 expressed a desire to discuss ways and means of extending Australia's trade with India.

[3] India has been importing most of the long-staple cotton from East Africa for weaving finer fabrics in her mills and she might as well negotiate for the allotment of a piece-goods quota in the East African market.

[4] The Government of India and the Afghan Government have recently (February 1938) decided to negotiate a trade pact on the basis of reciprocity.

[5] The Government of India have recently (1938) concluded a provisional trade agreement with the South African Union on the basis of the most-favoured-nation treatment in respect of those commodities not eligible for preferential treatment in virtue of any one or other of the Ottawa series of Agreements. It has been the subject of criticism both in the Assembly and outside, the defence of the Government of India being that in the absence of the Agreement India's exports of piece-goods, etc., to South Africa would have been subject to higher duties under the new South African Tariff Act.

to some of these countries have latterly been subjected. An attitude of *laissez-faire* in this matter does not appear to be very helpful at the present juncture, and delay will only add to our troubles. It has been proposed by commercial bodies like the Indian Merchants' Chamber, Bombay, that in order to lay a suitable foundation for negotiating trade treaties, India should adopt a scheme for regulating her imports and exports with reference to those countries which have adopted restrictive measures. At the same time, she should throw her full weight in favour of all such attempts as may be made to remove the present restrictions on world trade and to restore to that trade even a fraction of the freedom it enjoyed a few years ago.

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